86-44

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

1. Are federal district courts barred from enforcing agreements to arbitrate claims arising out of contractual relationships if those claims assert an implied right of action under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78a, *et seq.* (1982) (the "Exchange Act")?

2. Did Congress intend to create an exception to the United States Arbitration Act, 9 U.S.C. § 1, *et seq.* (1982), for claims under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961, *et seq.* (1982) ("RICO"), and require that all civil RICO claims be litigated in federal court, even if the parties have agreed to arbitrate those claims?

RULE 28.1 LIST

Non-Wholly Owned Subsidiaries and Affiliates of Shearson Lehman Brothers Inc.

Active Subsidiaries

Boston Hambro Corp.
Boulevard Investors Inc.
Boulevard Real Estate Corp.
Burlington Investors Inc.
E.B. Realty
Lombard Realty Corporation
Lowell Investors Inc.
Lowell Real Estate Corp.
Shearson Dat-Cheong Company Limited
Shearson Lehman/Finanz AG
Shearson/KM, Inc.

Inactive Subsidiaries

Genex Insurance Brokerage Ltd.
Mideast-American, Inc.

Affiliates

California S.A.
Shearson Financial Services of Oklahoma, Inc.
Shearson Financial Services of Texas, Inc.
Shearson Lehman Brothers SARL
Intermodal Equipment Associates
KCC Syndicate Managers, Inc.
McLeod Young Weir Limited
New World Corporation
Rex Moor Properties Incorporated
Sovran Energy Corp.

Non-Wholly Owned Subsidiaries and Affiliates of Shearson Lehman Brothers Holdings Inc., the parent company of Shearson Lehman Brothers Inc.*

American Express Asset Management Limited
American Express Asset Management N.V.
American Express Asset Management S.A.
American Express U.K. Holding Company Inc.
FGIC Corporation
Kuhn Loeb Lehman Brothers International B.V.
Lehman Brothers International UK Ltd.
Lehman International Finance N.V.
Lehman Overseas N.V.
LBKL 82-1 Investors Inc.
Shearson Lehman Broadgate North Inc.
Shearson Lehman Broadgate South Inc.

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* The parent company of Shearson Lehman Brothers Holdings Inc. is the American Express Company.

TABLE OF CONTENTS

	Page
Questions Presented	i
Rule 28.1 List	ii
Table of Authorities	vii
Statutory and Regulatory Provisions Involved	xvi
Opinions Below	2
Jurisdiction	2
Statement of the Case	3
Reasons for Granting the Writ	4
I. This Court Should Grant Certiorari to Resolve The Conflict Among the Circuits As to Whether Congress Intended to Prohibit the Enforcement of Agreements to Arbitrate Claims Arising Under § 10(b) of the Exchange Act	6
A. The Second and Eighth Circuit Courts of Appeals are in Direct Conflict As to Whether the *Wilko v. Swan* Exception to The Arbitration Act for Claims Under § 12(2) Of the Securities Act of 1933 Should Be Extended to Claims Under § 10(b) of the Exchange Act	6
1. The Second Circuit's decision in this case rests upon its own precedent extending *Wilko v. Swan* to § 10(b) claims, and its own view of public policy, rather than any analysis of Congressional intent	7
2. The Eighth Circuit's decision in *Phillips* rests upon this Court's recent pronouncements questioning the applicability of *Wilko v. Swan* to § 10(b) claims and the explicit Congressional mandate favoring arbitration	10

Page

3. The Second Circuit's decision conflicts with the clear intent of Congress and with this Court's recent decisions 13

4. The conflict among the circuits can only be resolved by this Court 15

B. The Continued Conflict and Confusion Among the Lower Courts Over the Applicability of *Wilko v. Swan* to § 10(b) Claims Requires Early Resolution in Order To Avoid Increased Congestion in the Lower Courts 16

II. This Court Should Grant Certiorari to Decide Whether, in Enacting the RICO Statute, Congress Intended to Exempt All Civil RICO Claims From the Coverage of the Arbitration Act 18

A. The Enforceability of Agreements to Arbitrate Civil RICO Claims is An Unresolved and Important Question of Federal Law, and the Second Circuit's Decision Will Only Increase the Conflict Among the District Courts on This Issue . . . 20

B. The Second Circuit's Decision in This Case Is in Direct Conflict With Congressional Intent, and Will Needlessly Burden the Courts and Litigants Unless it is Reviewed And Reversed 23

1. There is no evidence that Congress intended to create an exception to the Arbitration Act for all civil RICO claims . 23

2. Civil RICO claims rarely implicate public policy, as they almost always involve simple commercial disputes 25

Conclusion 28

Page

Appendices

A. Statutory and Regulatory Provisions Involved A-1

B. Opinion of the United States Court of Appeals for the Second Circuit A-6

C. Opinion of the United States District Court for the Southern District of New York..... A-19

D. Judgment of the United States Court of Appeals for the Second Circuit, entered on April 16, 1986 ..... A-30

E. District Court Cases Addressing the Enforceability of Agreements to Arbitrate § 10(b) Claims A-32

F. District Court Cases Addressing the Enforceability of Agreements to Arbitrate Civil RICO Claims A-43

TABLE OF AUTHORITIES

Cases	Page
AFP Imaging Corp. v. Ross, 780 F.2d 202 (2d Cir. 1985), *cert. denied* (United States June 30, 1986)	7
Allegaert v. Perot, 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977)	2, 7, 8
American Concept v. Irsay, No. 84 C 10026 (N.D. Ill. Oct. 4, 1985) (appeal pending)	20
American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968)	*passim*
Austad v. Drexel Burnham Lambert, Inc., No. 85-C-9759 (N.D. Ill. Mar. 27, 1986)	18
Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532 (3rd Cir.), *cert. denied*, 429 U.S. 1010 (1976)	8
Bale v. Dean Witter Reynolds, Inc., 627 F. Supp. 650 (D. Minn. 1986)	24, 26
Belke v. Merrill Lynch, Pierce, Fenner & Smith, 693 F.2d 1023 (11th Cir. 1982)	8
Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)	17
Bob Ladd, Inc. v. Adcock, 633 F. Supp. 241 (E.D. Ark. 1986)	24, 26
Brener v. Becker Paribas Inc., 628 F. Supp. 442 (S.D.N.Y. 1985)	24, 26
Coenen v. R.W. Pressprich & Co., 453 F.2d 1209 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972)	8

Page

Colonial Realty Corp. v. Bache & Co., 358 F.2d 178 (2d Cir.), *cert. denied*, 385 U.S. 817 (1966) 7

Comm'r v. Bilder, 369 U.S. 499 (1962) 23

Congregation Beth Yitzhok v. Briskman, 566 F. Supp. 555 (E.D.N.Y. 1983) 26

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Dean Witter Reynolds, Inc. v. Byrd, 105 S. Ct. 1238 (1985) ..... *passim*

De Lancie v. Birr, Wilson & Co., 648 F.2d 1255 (9th Cir. 1981) 8

Erlbaum v. Erlbaum, [1982] Fed. Sec. L. Rep. (CCH) ¶ 98,772 (E.D. Pa. July 13, 1982) 26

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Gorman v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 609 F. Supp. 1054 (S.D. Fla.), *aff'd*, 780 F.2d 1032 (11th Cir. 1985) (*en banc* rehearing pending) 15

Greater Continental Corp. v. Schechter, 422 F.2d 1100 (2d Cir. 1970) 7

Halliburton & Assocs., Inc. v. Henderson, Few & Co., 774 F.2d 441 (11th Cir. 1985) 8

Page

Haroco, Inc. v. American Nat. Bank and Trust Co., 747 F.2d 384 (7th Cir. 1984), *aff'd*, 105 S. Ct. 3291 (1985) (per curiam) 25

Herman & MacLean v. Huddleston, 459 U.S. 375 (1983) 6

Huss v. Goldman, Sachs & Co., No. 86-C-2680 (N.D. Ill. May 13, 1986) 26

Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,276 (W.D. Pa. Apr. 19, 1985) (appeal pending) 20, 24

King v. Drexel Burnham Lambert, Inc., No. 85-1717 (5th Cir. May 28, 1986) 16

King v. Lasher, 572 F. Supp. 1377 (S.D.N.Y. 1983) 27

Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017 (6th Cir. 1979) 8

Martin-Trigona v. D'Amato & Lynch, 559 F. Supp. 533 (S.D.N.Y. 1983) 26

Massachusetts Trustees v. United States, 377 U.S. 235 (1964) 23

McMahon v. Shearson/American Express, Inc., 618 F. Supp. 384 (S.D.N.Y. 1985), *aff'd in part, rev'd in part*, 788 F.2d 94 (2d Cir. 1986) . *passim*

McMahon v. Shearson/American Express, Inc., 788 F.2d 94 (2d Cir. 1986) ..... *passim*

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,781 (S.D.N.Y. June 14, 1986) 9

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore, 590 F.2d 823 (10th Cir. 1978) 8

Page

Miller v. Drexel Burnham Lambert, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,783 (11th Cir. June 17, 1986) (per curiam) 15

Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 105 S. Ct. 3346 (1985) ..... *passim*

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New York v. Saper, 336 U.S. 328 (1949) 23

Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 85-5156 (8th Cir. July 9, 1986) ..... *passim*

Pit Pros, Inc. v. Wolf, 554 F. Supp. 284 (N.D. Ill. 1983) 26

Posadas v. Nat. City Bank, 296 U.S. 497 (1936) .. 23

Price v. Drexel Burnham Lambert, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,790 (5th Cir. June 11, 1986) 6

Randall v. Loftsgaarden, No. 85-519 (United States July 2, 1986) 8, 23

Roes v. Paine, Webber, Jackson & Curtis, Inc., No. C84-2311A (N.D. Ga. Mar. 29, 1985) 21

Ross v. Mathis, 624 F. Supp. 110 (N.D. Ga. 1985) 19, 24, 27

Russell v. Shearson Lehman Bros., Inc., No. CA3-85-2335-R (N.D. Tex. Mar. 10, 1986) (appeal pending) 20

Page

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Sacks v. Dean Witter Reynolds, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,429 (C.D. Cal. Dec. 31, 1985) 24, 27

San Martine Compania de Navegacion v. Saguenay Terminals, Ltd., 293 F.2d 796 (9th Cir. 1961)..... 9

Schacht v. Brown, 711 F.2d 1343 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983) 18

Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974) 10, 13

Sedima, S.P.R.L. v. Imrex Co., 105 S. Ct. 3275 (1985) 18, 22

Shapiro v. United States, 335 U.S. 1 (1948)..... 23

Shotto v. Laub, 632 F. Supp. 516 (D. Md. 1986). 18

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Smoky Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,767 (5th Cir. May 13, 1986) (per curiam) 20, 22

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Steinberg v. The Illinois Co., No. 85-C-7131 (N.D. Ill. May 15, 1986) 18, 27

Page

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United States v. Will, 449 U.S. 200 (1980) 23

United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960) 14

Universal Marine Ins. Co. v. Beacon Ins. Co., 588 F. Supp. 735 (W.D.N.C. 1984) 21

Washington v. Miller, 235 U.S. 422 (1914) 24

Webb v. R. Rowland & Co., 613 F. Supp. 1123 (E.D. Mo. 1985) (appeal pending) 20

Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith Inc., 558 F.2d 831 (7th Cir. 1977) 8

West v. Drexel Burnham Lambert, Inc., 623 F. Supp. 26 (W.D. Wash. 1985) 26,27

Wilcox v. Ho-Wing Sit, 586 F. Supp. 561 (N.D. Cal. 1984) 21

Wilko v. Swan, 346 U.S. 427 (1953) ..... passim

Witt v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 602 F. Supp. 867 (W.D. Pa. 1985) 21

Statutes and Regulations	Page
Sherman Act, 15 U.S.C. § 1, *et seq.*	14
Securities Act of 1933, 15 U.S.C. § 77a, *et seq.*	7
Section 12(2), 15 U.S.C. § 77 l (2)	7
Section 14, 15 U.S.C. § 77n	7
Securities Exchange Act of 1934, 15 U.S.C. § 78a, *et seq.*	2
Section 10(b), 15 U.S.C. § 78j(b)	2
Section 19, 15 U.S.C. § 78s	9
Section 29(a), 15 U.S.C. § 78cc(a)	11
Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961, *et seq.*	2
18 U.S.C. § 1962	3
18 U.S.C. § 1964(b)	19
18 U.S.C. § 1964(c)	2
United States Arbitration Act, 9 U.S.C. § 1, *et seq.*	3
9 U.S.C. § 2	13
9 U.S.C. § 3	3
28 U.S.C. § 1254(1)	2
28 U.S.C. § 1292(a)(1)	4

Articles	Page
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Other Materials	
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Arbitration Rules 600-634 of the New York Stock Exchange, Inc., 2 N.Y.S.E. Guide (CCH) ¶¶ 2600-2634	9
Committee on Federal Legislation, "Reform of the Private Civil Action Provision of RICO," 41 *The Record of the Association of the Bar of the City of New York* 412 (May 1986)	19
Communication from Elizabeth McGrath, Chief, Judicial Information Branch, Statistical Analysis and Reports Division, Administrative Office of the United States Courts, Washington, D.C., dated June 27, 1986	22
Constitution of the New York Stock Exchange, Inc., 2 N.Y.S.E. Guide (CCH) ¶¶ 1351-1357 ..	9

Page

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Speech by Chief Justice Warren E. Burger to the American Arbitration Association and the Minnesota Bar Association, on August 21, 1985, reported by UPI on the same date 17

Speech by Chief Justice Warren E. Burger at New York University on November 18, 1982, reported in the Christian Science Monitor on November 24, 1982..... 17

Uniform Code of Arbitration, N.A.S.D. Manual (CCH) ¶¶ 3712-3743 ..... 9, 27

STATUTORY AND REGULATORY PROVISIONS INVOLVED*

United States Arbitration Act

Section 2, 9 U.S.C. § 2
Section 3, 9 U.S.C. § 3

Securities Act of 1933

Section 12(2), 15 U.S.C. § 77 l (2)
Section 14, 15 U.S.C. § 77n

Securities Exchange Act of 1934

Section 10(b), 15 U.S.C. § 78j(b)
Section 29(a), 15 U.S.C. § 78cc(a)

Racketeer Influenced and Corrupt Organizations Act

Section 1962, 18 U.S.C. § 1962
Section 1964(c), 18 U.S.C. § 1964(c)

Securities and Exchange Commission Regulation

Rule 10b-5, 17 C.F.R. § 240.10b-5

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* The text of these provisions is reproduced in full at Appendix A hereto.

No.

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OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners Shearson Lehman Brothers Inc., successor to Shearson/American Express Inc. ("Shearson"), and Mary Ann McNulty, defendants below, respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered on April 16, 1986, which affirmed in part and reversed in part an order of the United States

District Court for the Southern District of New York. The District Court enforced in part a pre-existing agreement between Shearson and plaintiffs, who were customers of Shearson, to arbitrate all disputes arising out of their customer-broker relationship. The District Court ordered arbitration of both the common law claims and the claims under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78a, *et seq.* (1982) (the "Exchange Act"), but refused to enforce the agreement with respect to plaintiffs' claims under § 1964(c) of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961, *et seq.* ("RICO").

On appeal, the Second Circuit ruled that district courts within its jurisdiction are barred from enforcing agreements to arbitrate claims arising under either § 10(b) or the RICO statute. The Second Circuit held that *Wilko v. Swan*, 346 U.S. 427 (1953), and its own precedents compelled this result. *See, e.g., Allegaert v. Perot*, 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977); *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968).

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit is reported at 788 F.2d 94, and is reproduced at Appendix B hereto. The opinion of the United States District Court for the Southern District of New York is reported at 618 F. Supp. 384, and is reproduced at Appendix C hereto.

JURISDICTION

The judgment of the Court of Appeals was entered on April 16, 1986. A copy of the judgment is reproduced at Appendix D hereto. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1) (1982).

STATEMENT OF THE CASE

From February 1980 through July 1982, respondents Eugene and Julia McMahon, either individually, jointly, or on behalf of various trusts, signed a series of Customer Agreements with a predecessor of Shearson, a brokerage firm. Each of these agreements provided for arbitration of any controversy relating to the various accounts. A typical agreement provided in part:

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I [the customer] may elect.

On October 26, 1984, respondents sued Shearson and Mary Ann McNulty, the registered representative who handled their accounts, in the United States District Court for the Southern District of New York. Respondents claimed that there had been excessive trading in their accounts, and that certain securities purchased for those accounts were not appropriate for their particular investment objectives. They alleged that the defendants' conduct constituted: (a) common law fraud, (b) a breach of fiduciary duty, (c) a violation of § 10(b) of the Exchange Act and Rule 10b-5 thereunder, and (d) a violation of § 1962 of the RICO statute. These claims all arose out of the same set of allegations, which complained about the manner in which the plaintiffs' securities accounts were handled.

Shearson and Ms. McNulty moved for an order to enforce the arbitration agreement pursuant to § 3 of the United States Arbitration Act, 9 U.S.C. § 1, *et seq.* (the "Arbitration Act"). The District Court, Hon. Lloyd F. MacMahon, adopted the reasoning of Justice White's concurring opinion in *Dean Witter*

Reynolds, Inc. v. Byrd, 105 S. Ct. 1238, 1244 (1985), and enforced the agreement to arbitrate the § 10(b) claims, as well as the common law claims. *McMahon*, 618 F. Supp. at 388. The District court ruled, however, that it was barred from enforcing the agreement to arbitrate respondents' RICO claims. *Id.* at 389. The Court then placed the RICO claims on the suspense docket pending the arbitration of the other claims.

Respondents appealed the District Court's order enforcing the agreement to arbitrate the § 10(b) claims, pursuant to 28 U.S.C. § 1292(a)(1). Petitioners cross-appealed the denial of their motion to arbitrate the RICO claims.

The Second Circuit ruled that district courts within its jurisdiction may not enforce arbitration agreements insofar as they apply to (a) claims under § 10(b) of the Exchange Act, or (b) civil RICO claims.

REASONS FOR GRANTING THE WRIT

The Second Circuit's decision forbidding the enforcement of agreements to arbitrate claims under § 10(b) of the Exchange Act is in direct conflict with the decision of the Eighth Circuit Court of Appeals in *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 85-5156 (8th Cir. July 9, 1986), which enforced an agreement to arbitrate § 10(b) claims. As the Eighth Circuit recognized, the conflict is clear and direct:

> Finally, we observe that the federal appellate courts, in the absence of precedent in their own circuit, tend to rely on precedent in other circuits. Ordinarily, then, in deciding a case of this kind, we would defer to the opinion of another circuit, such as rendered by the Second Circuit in *McMahon*, and avoid creating a conflict within the circuits. We believe, however, that the Supreme Court's opinions in *Scherk* and *Byrd* have invited a reexamination of the applicability of *Wilko* to claims arising under section 10(b) of the 1934 Act and Rule 10b-5. Because we are not bound by the precedents of other circuits, we are free to make a new

> assessment of this issue. We have made that assessment, and now create a conflict within the circuits. We assume the Supreme Court will eventually decide this question.

Phillips, slip op. at 14.

The Second Circuit's decision also conflicts with recent decisions of this Court and with the clear mandate of Congress in the Arbitration Act, which direct that all doubts are to be resolved in favor of arbitration. The Second Circuit allowed its distrust of arbitration to override Congressional intent and prevent arbitration of § 10(b) and civil RICO claims.

This Court will eventually have to decide the arbitrability of § 10(b) and civil RICO claims, and we respectfully suggest that it should do so now. The lower courts are burdened, on an almost daily basis, with motions to compel arbitration of such claims. Many of these courts are compelled by circuit court precedent to prohibit enforcement of arbitration agreements and to hear the resulting lawsuits. Others, relying upon recent decisions of this Court, have considered the issues to be open and have concluded that § 10(b) and RICO claims are arbitrable.[1]

Until this issue is resolved, parties to arbitration agreements will continue to be deprived of an efficient, expeditious, and less expensive alternative to federal courts for settling their disputes, while each passing day will clog the courts with more motions raising this issue, and with more lawsuits asserting claims that should be determined through arbitration.

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[1] Petitioners are aware of 118 cases nationwide that have decided the enforceability of agreements to arbitrate § 10(b) claims since *Byrd* was decided. 76 decisions, or approximately 64%, have held that § 10(b) claims must be arbitrated, while 42 decisions, or approximately 36%, have held that § 10(b) claims may not be arbitrated. One additional case stayed its decision pending the outcome of *Phillips*. A complete list of the district court decisions on this issue appears at Appendix E to this petition. *See also* Appendix F (listing 47 district court cases addressing the arbitrability of civil RICO claims).

I. This Court Should Grant Certiorari to Resolve the Conflict Among the Circuits As to Whether Congress Intended to Prohibit the Enforcement of Agreements to Arbitrate Claims Arising Under § 10(b) of the Exchange Act

The Eighth Circuit in *Phillips* was fully aware of the Second Circuit's decision in *McMahon*, and explicitly disagreed with it. The result is a direct "conflict within the Circuits." *Phillips*, slip op. at 14. This fundamental conflict between two circuit courts of appeals, both reviewing the same legal arguments, is mirrored by the conflict among the district courts on this issue. *See* n.1, *supra*.

With the force of the Eighth Circuit's reasoning as support, there can be no doubt that more district courts will be faced with motions to compel arbitration.[2] This enormous consumption of judicial time and resources will continue until this Court decides the issue.

A. The Second and Eighth Circuit Courts of Appeals are In Direct Conflict As to Whether the *Wilko v. Swan* Exception to the Arbitration Act for Claims Under § 12(2) Of the Securities Act of 1933 Should Be Extended to Claims Under § 10(b) of the Exchange Act

Congress did not create a private remedy for violations of § 10(b) of the Exchange Act. Instead, a judicially-implied private right of action evolved over the years. *See Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983). Plaintiffs in securities actions now routinely claim violations of § 10(b), usually on the basis of the same facts alleged to support a claim of common law fraud. Common law fraud claims, of course, are arbitrable even if they are based upon the same allegations as federal securities law claims. *Byrd*, 105 S. Ct. at 1241. Whether § 10(b)

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[2] Motions to compel arbitration will continue to be made even in those circuits where such agreements are not enforceable, in order to prevent a later claim of waiver should this Court determine otherwise. *See, e.g., Price v. Drexel Burnham Lambert, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,790 at 93,884 (5th Cir. June 11, 1986) (failure to move for arbitration of state law claims, although pre-*Byrd*, nevertheless waived right to arbitration).

claims can be arbitrated, however, is a question that has split the district and circuit courts.

The arguments on both sides of this issue have been fully developed over the years, in decisions from this Court, from the circuit courts of appeals, and from numerous district courts. Further consideration by the lower courts will create conflict, not clarification.

1. The Second Circuit's decision in this case rests upon its own precedent extending *Wilko v. Swan* to § 10(b) claims, and its own view of public policy, rather than any analysis of Congressional intent

The Second Circuit gave two reasons for precluding enforcement of agreements to arbitrate § 10(b) claims: prior Second Circuit precedent extending *Wilko v. Swan*, 346 U.S. 427 (1953) to § 10(b) claims[3] and the Second Circuit's view, based upon a fundamental distrust of arbitration, that "public policy" mandates resolution of these issues in a judicial forum. *McMahon*, 788 F.2d at 97.

In *Wilko*, this Court determined that the "non-waiver" provision of the Securities Act of 1933, 15 U.S.C. § 77a, *et seq.* (1982) (the "1933 Act"), when coupled with the explicit and unique procedural and substantive rights granted under § 12(2) of that Act, barred enforcement of an agreement to arbitrate that explicitly-created remedy. The *Wilko* Court held that the right to select a judicial forum was a "provision" of the 1933 Act, and thus subject to § 14 of the 1933 Act, 15 U.S.C. § 77n (1982), which voids any "stipulation" waiving compliance with any "provision" of that Act. *Wilko*, 346 U.S. at 434-35.

The reasoning of *Wilko* was thus limited to the specific language of the 1933 Act, and in particular to the express statutory remedy in § 12(2). As this Court has recently reconfirmed, the

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[3] *See AFP Imaging Corp. v. Ross*, 780 F.2d 202, 205 (2d Cir. 1985), *cert. denied*, (United States June 30, 1986); *Allegaert*, 548 F.2d at 436-38 (1977); *Greater Continental Corp. v. Schechter*, 422 F.2d 1100, 1103 (2d Cir. 1970); *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178, 183 n.5 (2d Cir.), *cert. denied* 385 U.S. 817 (1966).

1933 Act and the Exchange Act should not necessarily be construed *in pari materia*, but should be analyzed separately according to the language and purpose of each statute. *Randall v. Loftsgaarden*, No. 85-519 (United States July 2, 1986).

Nevertheless, several circuit courts of appeals, prior to this Court's decision in *Byrd*, extended *Wilko* to bar arbitration of § 10(b) claims.[4] Even those courts that extended *Wilko* to § 10(b) claims did not forbid the arbitration of all securities law claims, however, *Wilko* does not apply to disputes between members of the securities exchanges or the National Association of Securities Dealers, Inc., who are subject to rules mandating arbitration. *See, e.g., Halliburton & Assocs.*, 774 F.2d at 444-45; *Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209, 1212 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972). Nor does *Wilko* apply where arbitration is selected *after* the dispute has arisen. *See, e.g., Coenen*, 453 F.2d at 1213; *Gardner v. Shearson, Hammill & Co.*, 433 F.2d 367, 368 (5th Cir. 1970) (per curiam), *cert. denied*, 401 U.S. 978 (1971).

To the extent that the Second Circuit's decision is based on a "public policy" that § 10(b) claims must be resolved in a judicial forum, it reflects a judicial distrust of arbitration that this Court has expressly rejected. As this Court commented in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985):

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[4] *See Surman v. Merrill Lynch, Pierce, Fenner & Smith*, 733 F.2d 59, 61-62 (8th Cir. 1984); *Belke v. Merrill Lynch, Pierce, Fenner & Smith*, 693 F.2d 1023, 1025-26 (11th Cir. 1982); *De Lancie v. Birr, Wilson & Co.*, 648 F.2d 1255, 1258-59 (9th Cir. 1981); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1030 (6th Cir. 1979); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823, 827-29 (10th Cir. 1978); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 558 F.2d 831, 833-35 (7th Cir. 1977); *Allegaert*, 548 F.2d at 436-38 (1977); *Sibley v. Tandy Corp.*, 543 F.2d 540, 543 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977); *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 53[illegible] (3rd Cir.), *cert. denied*, 429 U.S. 1010 (1976).

> [W]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.

Id. at 3354.

Indeed, the securities industry, in conjunction with the Securities and Exchange Commission ("SEC") and other interested parties, has developed and established procedures for arbitrating securities law claims that provide protection to the public and to the policies underlying the securities laws.[5] Contrary to any concern that may have been expressed by the courts about the ability of arbitrators to resolve securities law claims fairly and competently, the historical evidence demonstrates that arbitration governed by these procedures effectively carries out the public policies underlying the securities laws. *See* C. Katsoris, *The Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279 (1984).

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[5] Arbitration is a structured forum subject to a clear set of rules. *See, e.g.*, Constitution of the New York Stock Exchange, Inc., Art. VIII, 2 N.Y.S.E. Guide (CCH) ¶¶ 1351-1357; Arbitration Rules 600-634 of the New York Stock Exchange, Inc., 2 N.Y.S.E. Guide (CCH) at ¶¶ 2600-2634. *See generally*, Uniform Code of Arbitration, N.A.S.D. Manual (CCH) ¶¶ 3712-3743. These rules have been expressly approved by the SEC, which has found them to be in the public interest and in furtherance of just and equitable principles of trade. *See* SEC Securities Exchange Act Release No. 16390 (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979).

The SEC, moreover, retains jurisdiction to correct any perceived abuses or unfairness in the arbitration rules, pursuant to § 19 of the Exchange Act, 15 U.S.C. § 78s (1982). Furthermore, arbitrators are bound to follow the law in adjudicating § 10(b) claims. *Wilko*, 346 U.S. at 436 (1953). Manifest disregard of the law is one ground to vacate an arbitration award. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,781 (S.D.N.Y. June 14, 1986) (Weinfeld, J.) (manifest disregard of law under Rule 10b-4 required arbitrators' award to be vacated). *See also Swift Indus., Inc. v. Botany Indus., Inc.*, 466 F.2d 1125, 1130-31 (3d Cir. 1972); *San Martine Compania de Navegacion v. Saguenay Terminals, Ltd.*, 293 F.2d 796, 801 (9th Cir. 1961).

2. The Eighth Circuit's decision in *Phillips* rests upon this Court's recent pronouncements questioning the applicability of *Wilko v. Swan* to § 10(b) claims and the explicit Congressional mandate favoring arbitration

The Eighth Circuit, unlike the Second Circuit, recognized that this Court in recent years has consistently reaffirmed the strong national policy favoring arbitration. *Phillips*, slip op. at 4. As the *Phillips* court noted, this Court's decision in *Wilko* remains a carefully-limited decision, based upon the special characteristics of the statutorily-created cause of action under § 12(2) of the 1933 Act.

This Court has twice commented that *Wilko* does not control the question of the arbitrability of claims under § 10(b) of the Exchange Act. In *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974), this Court enforced an agreement to arbitrate disputes involving § 10(b) claims in an international context, stating:

> At the outset, a colorable argument could be made that even the semantic reasoning of the *Wilko* opinion does not control the case before us. *Wilko* concerned a suit brought under § 12(2) of the Securities Act of 1933, which provides a defrauded purchaser with the "special right" of a private remedy for civil liability, 346 U.S. at 431. There is no statutory counterpart of § 12(2) in the Securities Exchange Act of 1934, and *neither § 10(b) of that Act nor Rule 10b-5 speaks of a private remedy to redress violations of the kind alleged here.* While federal case law has established that § 10(b) and Rule 10b-5 create an implied private cause of action, the Act itself does not establish the "special right" that the Court in *Wilko* found significant. Furthermore, while both the Securities Act of 1933 and the Securities Exchange Act of 1934 contain sections barring waiver of compliance with any "provision" of the respective Acts, certain of the "provisions" of the 1933 Act that the Court held could not be waived by Wilko's agreement to arbitrate find no counterpart in the 1934 Act.

Scherk, 417 U.S. at 513-14 (citations and footnote omitted) (emphasis added).

In *Byrd*, this Court noted the doubts expressed in *Scherk* about the applicability of *Wilko* to § 10(b) claims. It did not decide the issue, however, as the defendant had not sought to compel arbitration of the § 10(b) claim in the district court. *Byrd*, 105 S. Ct. at 1240 n.1.

Justice White, in his concurring opinion in *Byrd*, discussed the reasoning of *Wilko* and its inapplicability to claims under § 10(b) of the Exchange Act. He observed that the validity of the conclusion that § 10(b) claims are not arbitrable "is a matter of substantial doubt." *Id.* at 1244. He stated that "*Wilko*'s reasoning cannot be mechanically transplanted to the 1934 Act," because a private agreement to arbitrate an implied cause of action cannot constitute a waiver of a "provision" of the Exchange Act where the Act makes no provision for a private right of action. *Id.* Given that a private right of action under § 10(b) has been judicially implied, rather than Congressionally mandated, the non-waiver provision of the Exchange Act, § 29(a), 15 U.S.C. § 78cc(a), "is thus literally inapplicable." *Id.* at 1244. Moreover, the virtual identity of § 10(b) claims and claims sounding in common law fraud, which are clearly arbitrable, argues against any special exception to the Arbitration Act for § 10(b) claims. *Id.* at 1244.

The Eighth Circuit analyzed this question in light of Justice White's concurring opinion in *Byrd* and this Court's recent reaffirmation of the strong national policy favoring arbitration. The *Phillips* court noted that, unlike common law claims for fraud or deceit, § 12(2) requires defendants to prove lack of due care. By contrast, § 10(b) requires plaintiffs to prove *scienter*, as in common law fraud. The Eighth Circuit also noted the significant differences in the jurisdictional provisions of the two statutes. *Phillips*, slip op. at 9-10.

After careful analysis, the Eighth Circuit concluded:

> Based on these differences between the 1933 and 1934 Acts, and on the strong federal policy favoring enforcement of arbitration agreements, we conclude that *Wilko*'s holding and rationale does not extend to claims arising under section 10(b) of the 1934 Act and Rule 10b-5. The non-waiver provision of the 1934 Act, section 29(a), simply does not override the Arbitration Act in the same manner as section 14 of the 1933 Act when it is not buttressed by special rights and broad jurisdictional provisions similar to those found in the 1933 Act. . . . We hold, then, that Congress has not evinced an intention to preclude the waiver of judicial remedies for the section 10(b) and Rule 10b-5 rights at issue here.

Phillips, slip op. at 10 (footnotes omitted).

A second basis for the Second Circuit's decision was its belief that "public policy" requires that § 10(b) claims be heard in federal court. The Eighth Circuit, however, rejected that argument, noting:

> As support for its contention that 1934 Act claims are not arbitrable, Phillips argues that arbitration is less effective than adjudication in enforcing a plaintiff's rights under the 1934 Act. We believe that this argument, if it has any validity, is largely beside the point. Congress, through the Arbitration Act, as well as the Supreme Court have expressed increased approval for the use of arbitration rather than adjudication. . . . The question here is whether Congress has created an exception to the mandate of the Arbitration Act for a plaintiff's judicially implied section 10(b) and Rule 10b-5 rights. We conclude that it has not.

Phillips, slip op. at 10 n.16.

The conflict between the Second and Eighth Circuits is clear and direct. Did Congress intend to create an exception to the Arbitration Act for implied claims under § 10(b)? Can the courts, based on their own views of public policy, decide that some issues

are simply too important to be entrusted to arbitrators? The Second Circuit held that the *Wilko* exception to the Arbitration Act applies to § 10(b) claims, and that "public policy" mandates resolution of these issues in a judicial forum. The Eighth Circuit is squarely opposed to the Second Circuit on both points. Only this Court can resolve the conflict.

3. The Second Circuit's decision conflicts with the clear intent of Congress and with this Court's recent decisions

The Second Circuit's mistrust of arbitration directly conflicts with the Congressional policy codified in the Arbitration Act, in effect since 1925, and with recent decisions of this Court.

The Arbitration Act states in relevant part:

> A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof . . . *shall be valid, irrevocable, and enforceable*, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2 (1982) (emphasis added). Congress intended the Arbitration Act to reverse the courts' general hostility towards arbitration agreements and to expressly state the strong public policy in favor of enforcing such agreements. *Mitsubishi*, 105 S. Ct. at 3353-54 & n.14; *Byrd*, 105 S. Ct. at 1241-43; *Southland Corp. v. Keating*, 465 U.S. 1, 10-16 (1984); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983); *Scherk*, 417 U.S. at 510-11. This Court has recognized that the effect of § 2 of the Act was to "create a body of federal substantive law of arbitrability," and that "the Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. . ." *Moses H. Cone Memorial Hosp.*, 460 U.S. at 24-25; *see also Southland Corp.*, 465 U.S. at 10-16.

In *Mitsubishi*, this Court, citing Justice White's concurring opinion in the *Byrd* case, stated that courts must enforce the federal policy favoring arbitration manifested in the Arbitration Act, absent a clear Congressional intent to create an exception. *Id.* at 3355. Employing that standard, this Court held that an agreement to arbitrate disputes arising out of an international business relationship was enforceable even as to antitrust claims under the Sherman Act, 15 U.S.C. § 1, *et seq.* (1982). *Id.* at 3361.

This Court observed that, despite the importance of antitrust claims, there was no reason not to enforce an international agreement to arbitrate such claims:

> *By agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute*; it only submits to their resolution in an arbitral, rather than a judicial, forum. It trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration. We must assume that *if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history.* Having made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue.

Mitsubishi, 105 S. Ct. at 3355 (citation omitted) (emphasis added); *see also United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 584-85 (1960) (absent "any express provision excluding a particular grievance from arbitration, we think only the most forceful evidence of a purpose to exclude the claim from arbitration can prevail").[6]

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[6] Even the dissent in *Mitsubishi*, which viewed special, statutorily-created rights as potentially exempt from the Arbitration Act, noted that § 10(b) claims that essentially parallel contract and fraud claims may be arbitrated. *Mitsubishi*, 105 S. Ct. at 3364 (citing *Scherk*, 417 U.S. 506).

Mitsubishi thus teaches that even express statutory claims are arbitrable absent explicit Congressional intent to the contrary. The Second Circuit's decision in this action stands *Mitsubishi*'s analysis on its head. By refusing to enforce an agreement to arbitrate an implied right of action, the Second Circuit gave greater weight to its own view of the importance of a judicial forum for an implied cause of action than it gave to the explicit Congressional mandate – codified in the Arbitration Act – that arbitration agreements should be enforced.

4. The conflict among the circuits can only be resolved by this Court

The decision in *Phillips*, although clearly reasoned, does not develop any new points. Rather, it states in succinct form the arguments first raised by this Court in *Scherk*, which were further developed by Justice White in his concurring opinion in *Byrd*, and which were then fully developed in the intense litigation and numerous decisions of the past year. The question of the arbitrability of § 10(b) claims will not benefit from further development in the lower courts.

Although the arguments are clear-cut, the circuits are sharply divided on which arguments are correct. Since this Court's decision in *Byrd*, the Fifth and Eleventh Circuits, in addition to the Second Circuit, have precluded the district courts within their jurisdictions from enforcing agreements to arbitrate § 10(b) claims. In *Miller v. Drexel Burnham Lambert, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,783 (11th Cir. June 17, 1986) (per curiam), the Eleventh Circuit, without analyzing the effect of *Mitsubishi* or Justice White's concurrence in *Byrd*, held that because this Court in *Byrd* did not expressly overrule Eleventh Circuit precedent extending *Wilko v. Swan* to § 10(b) claims, it was obliged to follow its own precedent.[7]

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[7] The continuing validity of *Miller* is in doubt, however, as the Eleventh Circuit is now reconsidering this issue *en banc*. *Gorman v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 609 F. Supp. 1054 (S.D. Fla.), *aff'd*, 780 F.2d 1032 (11th Cir. 1985) (*en banc* consideration granted Oct. 3, 1985).

The Fifth Circuit in *King v. Drexel Burnham Lambert, Inc.*, No. 85-1717 (5th Cir. May 28, 1986), affirmed a district court decision reaching the same conclusion. Already, other cases expressly raising the enforceability of agreements between brokers and their customers to arbitrate § 10(b) claims are now on appeal before the Third, Fourth, Sixth, Seventh, Ninth and Eleventh Circuits. *See* Appendix E. Given the clear-cut nature of the arguments, decisions on these appeals will only increase the conflicts among the circuits.

B. The Continued Conflict and Confusion Among the Lower Courts Over the Applicability of *Wilko v. Swan* to § 10(b) Claims Requires Early Resolution in Order to Avoid Increased Congestion in the Lower Courts

As long as the arbitrability of § 10(b) claims remains unclear, the issue will be the subject of motions and appeals consuming inordinate amounts of judicial resources. In the brief period since *Byrd* was decided, at least 118 decisions have dealt with this issue. *See* Appendix E. More are being reported every week.

In addition to the motions currently pending in already-filed cases, each week brings new filings of securities-related claims. Statistics compiled by the Administrative Office of the United States Courts reveal that during the twelve months ended March 31, 1986 a total of 3,064 "Securities, Commodities and Exchanges" private civil actions were filed in federal district courts.[8] This flood of private securities lawsuits, many raising claims subject to arbitration agreements, will continue to force the district courts to decide the enforceability of such agreements and, perhaps, to decide claims that the parties had agreed should be arbitrated.

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[8] *See* Federal Judicial Workload Statistics, Table C-2 at 13 (March 1986). In the year ended June 30, 1985, 3,072 such cases were filed. *See* Annual Report of the Director of the Administrative Office of the United States Courts, Table C-2 at 283 (1985). This represents a 40% increase over comparable figures for 1982. *See* Annual Report of the Director of the Administrative Office of the United States Courts, Table C-2 at 217 (1982).

The burden on the district courts of leaving this issue unresolved is not limited to deciding numerous motions to compel. When the courts within the Second, Fifth and Eleventh Circuits are added to the substantial number of courts that may choose to follow such precedent,[9] it becomes clear that, unless this Court acts, a significant number of otherwise arbitrable disputes will be tried in already overcrowded federal district courts.[10]

The Arbitration Act reflects a strong Congressional policy in favor of reducing congestion in our federal courts. Such congestion is one of the most serious problems facing the federal judiciary today.[11] When parties agree that a claim should be resolved out of court, only explicit Congressional intent should override that decision and require the expenditure of the time and resources required by a federal lawsuit. In this case, neither Congressional intent nor the language of the Exchange Act requires such a waste of time and judicial resources.[12]

(footnote continued)

[9] The *McMahon* decision, although less persuasively reasoned than *Phillips*, will undoubtedly carry significant weight because of the Second Circuit's acknowledged expertise and influence in securities law issues. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting) (referring to the Second Circuit as the "Mother Court" in securities law).

[10] In the year prior to the Second Circuit's decision in this case, the district courts of New York addressed the arbitrability of claims under the Exchange Act in 12 decisions, 9 of which held such claims to be arbitrable. In the three months since the Second Circuit's decision in this case, 10 more cases in the New York district courts have addressed this issue and have adhered to the Second Circuit's decision. A full list of these cases can be found in Appendix E to this petition.

[11] Speech by Chief Justice Warren E. Burger to the American Arbitration Association and the Minnesota Bar Association, on August 21, 1985, reported by UPI on the same date; Speech by Chief Justice Warren E. Burger at New York University on November 18, 1982, reported in the Christian Science Monitor on November 24, 1982.

[12] A finding that § 10(b) claims are arbitrable will also eliminate another source of waste – the maintenance of duplicative proceedings in separate forums. As a result of this Court's decision in *Byrd*, federal courts are required to compel arbitration of state law claims. *See Byrd*, 105 S. Ct. at 1241. If at the same

(footnote continued)

Petitioners respectfully submit that this Court should grant certiorari and resolve the conflict among the circuits by reversing the Second Circuit's decision barring the enforcement of agreements to arbitrate § 10(b) claims.

II. This Court Should Grant Certiorari to Decide Whether, In Enacting the RICO Statute, Congress Intended to Exempt All Civil RICO Claims From the Coverage of the Arbitration Act

Congress enacted RICO principally to combat the infiltration of legitimate business by organized crime. *United States v. Turkette*, 452 U.S. 576, 591 (1981). In the years since its passage, however, the private cause of action under RICO has been "evolving into something quite different from the original conception of its enactors." *Sedima, S.P.R.L. v. Imrex Co.*, 105 S. Ct. 3275, 3287 (1985). "Racketeering" is becoming a basic claim in commercial disputes; ordinary customer complaints about their securities brokers are now RICO claims.[13] As the Seventh Circuit has observed, Congress inadvertently "may well have created a runaway treble damage bonanza for the already excessively litigious." *Schacht v. Brown*, 711 F.2d 1343, 1361 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983).

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time courts are required to hear federal claims based on the same facts, parallel – and most likely duplicative – proceedings will result. *See Shotto v. Laub*, 632 F. Supp. 516, 523 & n.10, 529 (D. Md. 1986); *Steinberg v. The Illinois Co.*, No. 85-C-7131 (N.D. Ill. May 15, 1986); *Austad v. Drexel Burnham Lambert, Inc.*, No. 85-C-9759 (N.D. Ill. Mar. 27, 1986).

[13] "RICO claims are now added as a matter of course in virtually all cases challenging securities transactions." American Institute of Certified Public Accountants, "The Authority to Bring Private Treble-Damage Suits Under 'RICO' Should Be Reformed," *AICPA White Paper On Civil RICO* at 2 (July 31, 1985), *reprinted in* Oversight on Civil RICO Suits: Hearings on Oversight on Civil RICO Suits Brought Under 18 U.S.C. 1964(c) Before the Senate Committee on the Judiciary, 99th Cong., 1st Sess. 251, 255 (1985) (hereinafter cited as "*AICPA White Paper*").

Indeed, despite the Second Circuit's belief that the policies underlying RICO are too important to be left to arbitrators, the arbitration of civil RICO claims arising out of normal commercial relationships would have no effect on the types of claims RICO was meant to address: criminal actions, civil proceedings by the federal government pursuant to 18 U.S.C. § 1964(b), or lawsuits by private plaintiffs against mobsters attempting to infiltrate their businesses.[14] *See Ross v. Mathis*, 624 F. Supp. 110, 117 n.6 (N.D. Ga. 1985). This petition addresses the validity of agreements between parties to legitimate business transactions who have previously agreed to arbitrate any disputes. There is thus no reason, either in public policy or Congressional intent, for district courts – rather than arbitrators – to be burdened with hearing these claims simply because a plaintiff has labelled them "racketeering."

The enforceability of agreements to arbitrate such claims is an open question, and the Second Circuit's decision in this case insures that it will stay unresolved. The strong trend of district court decisions since *Mitsubishi* was to direct arbitration of civil RICO claims.[15] However, those courts bound by the Second Circuit's decision, or which choose to follow it, will now find themselves in conflict with that trend. As the growing tide of RICO cases washes over the district courts, the conflict and confusion among the courts on this issue will only increase. In order to resolve this conflict at an early stage, and to avoid the unnecessary burden on district courts that will result from the

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[14] Unfortunately, as the New York City Bar Association reported, "[c]ivil RICO has done literally nothing to advance Congress' goal of providing for 'an assault on organized crime and its economic roots.' This is hardly surprising: litigious though our society is, few would expect those injured in their businesses by the activities of 'the archetypal, intimidating mobster[s]' to serve summonses and complaints on such defendants." Committee on Federal Legislation, "Reform of the Private Civil Action Provision of RICO," 41 *The Record of the Association of the Bar of the City of New York* 412, 416 (May 1986) (footnotes omitted). Even rarer than a civil action against a member of organized crime would be a dispute between a mobster and a victim that was subject to an arbitration agreement.

[15] Appendix F to this petition lists 47 district court decisions that have addressed the enforceability of agreements to arbitrate civil RICO claims.

Second Circuit's *per se* rule that RICO claims can never be arbitrated, no matter how mundane the underlying dispute, this Court should grant certiorari to decide the question.

A. The Enforceability of Agreements to Arbitrate Civil RICO Claims is An Unresolved and Important Question of Federal Law, and the Second Circuit's Decision Will Only Increase the Conflict Among the District Courts on This Issue

This Court has never decided whether agreements to arbitrate civil RICO claims are enforceable. The Second Circuit is the only circuit court of appeals to have decided the issue, but four other cases raising the issue are now pending before the Third, Fifth, Seventh and Eighth Circuits.[16] In addition, the Fifth Circuit, although initially ruling that civil RICO claims are not arbitrable, upon reconsideration recently remanded the case to the district court, noting that this Court's decision in *Mitsubishi* may require the enforcement of agreements to arbitrate RICO claims. *Smoky Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,767 at 93,755 (5th Cir. May 13, 1986) (per curiam).

The issue has been intensely litigated in the district courts. At least 28 decisions have held that civil RICO claims are arbitrable, while 19 decisions, many prior to *Mitsubishi*, have held that they are not. *See* Appendix F.

Prior to the Second Circuit's decision in this matter, the conflict appeared to be headed toward resolution. District courts were deciding in favor of arbitration based upon this Court's decision in *Mitsubishi*. In *Mitsubishi*, this Court corrected the mistaken

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[16] *See Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,276 (W.D. Pa. Apr. 19, 1985) (RICO claims are arbitrable) (appeal pending); *Russell v. Shearson Lehman Bros., Inc.*, No. CA3-85-2335-R (N.D. Tex. Mar. 10, 1986) (RICO claims are arbitrable) (appeal pending); *American Concept v. Irsay*, No. 84 C 10026 (N.D. Ill. Oct. 4, 1985) (RICO claims are not arbitrable) (appeal pending); *Webb v. R. Rowland & Co.*, 613 F. Supp. 1123 (E.D. Mo. 1985) (RICO claims are not arbitrable) (appeal pending).

assumption held by many district courts that antitrust claims could never be arbitrated. As this Court made clear, the dispositive question is whether Congress intended to exempt a particular claim from the requirements of the Arbitration Act. 105 S. Ct. at 3355.

Several of the district court decisions holding that RICO claims are not arbitrable were decided before *Mitsubishi*, and thus were based upon the assumption that antitrust claims could never be arbitrated. Analogizing RICO claims to antitrust claims, those courts concluded that RICO claims also could not be arbitrated.[17] The clear majority of the 39 district court cases deciding this issue since *Mitsubishi*, however, enforced agreements to arbitrate civil RICO claims. *See* Appendix F.

As noted above, this Court's decision in *Mitsubishi* had a similar effect in the Fifth Circuit. In *Smoky Greenhaw*, 785 F.2d 1274 (5th Cir. 1986), the Fifth Circuit initially ruled that civil RICO claims are not arbitrable. Upon reconsideration, however, it withdrew that portion of its decision, stating:

> Although *Mitsubishi* arose in an international antitrust dispute and its holding purports to be limited to that context, we believe that its broad language may carry significance for domestic disputes as well. The parties in this case should have the opportunity to argue the applicability of *Mitsubishi* to domestic RICO claims before the District Court. We therefore amend our opinion to refuse to decide the arbitrability *vel non* of the plaintiffs' RICO claim and, on remand, leave to the District Court the task of deciding that issue on the full briefing and argument of the parties.

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[17] The antitrust analogy formed the basis for the leading pre-*Mitsubishi* decision regarding civil RICO arbitrability. *See S.A. Mineracao da Trindade-Samitri v. Utah Int'l Inc.*, 576 F. Supp. 566, 575 (S.D.N.Y. 1983), *order certified for interlocutory appeal*, 579 F. Supp. 1049 (S.D.N.Y.), *appealed on other grounds and affirmed*, 745 F.2d 190 (2d Cir. 1984). Other pre-*Mitsubishi* decisions adopted the reasoning of that decision. *See Roes v. Paine, Webber, Jackson & Curtis, Inc.*, No. C84-2311A (N.D. Ga. Mar. 29, 1985); *Witt v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 602 F. Supp. 867, 870 (W.D. Pa. 1985); *Wilcox v. Ho-Wing Sit*, 586 F. Supp. 561, 567 (N.D. Cal. 1984); *Universal Marine Ins. Co. v. Beacon Ins. Co.*, 588 F. Supp. 735, 738 (W.D.N.C. 1984).

Smoky Greenhaw, Fed. Sec. L. Rep. ¶ 92,767 at 93,755.

It is thus likely that the district courts, applying the reasoning of *Mitsubishi* to the RICO claims actually being asserted, would have developed a consistent and reasoned jurisprudence on this issue. The Second Circuit, however, by issuing a *per se* rule that RICO claims can never be arbitrated, put an abrupt end to any such analysis in the district courts bound by its decision. Moreover, the decision could lead district courts outside the Second Circuit to adopt a similar *per se* rule barring arbitration of all RICO claims, regardless of the nature of the underlying dispute.

The importance to the federal judiciary of enforcing agreements to arbitrate civil RICO claims is demonstrated by the growing number of such claims being brought in the federal courts. As this Court has noted, the number of civil RICO actions has risen dramatically each year since the statute's passage. *Sedima*, 105 S. Ct. at 3277-78 & n.1.[18] According to the Administrative Office of the United States Courts, which compiles the annual Judicial Workload Statistics, a total of 474 civil RICO cases were filed in the district courts between December 1, 1985 and April 30, 1986.[19] As litigants become more comfortable with charging "racketeering" in commercial disputes, the number of RICO claims will only increase. Each day that goes by ensures that more courts will be required to adjudicate commercial disputes that—under any other name but RICO—would be submitted to an arbitrator.

The confusion and conflict concerning the enforceability of agreements to arbitrate civil RICO claims should be resolved by

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[18] As the Court noted in *Sedima* at 3277 n.1, according to the Report of the Ad Hoc Civil RICO Task Force, A.B.A. Section of Corp., Banking & Bus. Law at 55 (1985) (hereinafter cited as "*ABA Report*"), of the approximately 270 civil RICO trial court decisions between passage of the statute in 1970 and the end of 1984, 3% of the decisions were rendered in the decade of the 1970's and 43% in 1984.

[19] Communication from Elizabeth McGrath, Chief, Judicial Information Branch, Statistical Analysis and Reports Division, Administrative Office of the United States Courts, Washington, D.C., dated June 27, 1986.

this Court before the increasing volume of such claims threatens to overwhelm our court system. *See Dawson Chemical Co. v. Rohm & Haas Co.*, 448 U.S. 176, 185 (1980) (certiorari granted to forestall a possible conflict in the lower courts on an important issue); *Massachusetts Trustees v. United States*, 377 U.S. 235, 237 (1964) ("a considerable number of suits are pending in the lower courts which will turn on resolution of these issues"); *Comm'r v. Bilder*, 369 U.S. 499, 501 (1962) (citing "need for a uniform rule"); *see also New York v. Saper*, 336 U.S. 328, 329 (1949); *Shapiro v. United States*, 335 U.S. 1, 4 (1948).

B. The Second Circuit's Decision in This Case is in Direct Conflict With Congressional Intent, and Will Needlessly Burden the Courts and Litigants Unless it is Reviewed and Reversed

The Second Circuit erred in this action by failing to look to Congressional intent to determine whether RICO claims are arbitrable. Instead, the Court created its own exception to the Arbitration Act, based upon purported "policy considerations" that appear to have little to do with the types of RICO claims district courts actually face. In order to correct this mistaken decision and avoid the needless burden on the courts that will ensue, this Court should grant certiorari and reverse.

1. There is no evidence that Congress intended to create an exception to the Arbitration Act for all civil RICO claims

This Court stated in *Mitsubishi* that the strong national policy favoring arbitration requires the enforcement of agreements to arbitrate statutory claims unless Congress has expressed an intent to the contrary. *Mitsubishi*, 105 S. Ct. at 3355.[20] Nothing

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[20] Indeed, with respect to rights expressly created by statute, such a rule is mandated by principles of statutory construction. "The cardinal rule is that repeals by implication are not favored." *Posadas v. Nat. City Bank*, 296 U.S. 497, 503 (1936); *see United States v. Will*, 449 U.S. 200, 221 (1980). Absent a clear and manifest expression of intention by the legislature to repeal its prior enactment, a subsequent statute will be construed as consistent with a prior statute. *See Posadas*, 296 U.S. at 503; *see also Randall v. Loftsgaarden*, No. 85-519

(footnote continued)

in the language of the RICO statute, whether as originally enacted or subsequently amended, either expressly or impliedly prohibits the arbitration of private RICO claims.[21] Nor is there anything in the legislative history of RICO suggesting a Congressional intent to bar parties from agreeing to arbitrate RICO claims. *Bob Ladd, Inc. v. Adcock*, 633 F. Supp. 241, 243-44 (E.D. Ark. 1986); *Bale v. Dean Witter Reynolds, Inc.*, 627 F. Supp. 650, 654 (D. Minn. 1986); *Sacks v. Dean Witter Reynolds, Inc.*, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,429 at 92,642 (C.D. Cal. Dec. 31, 1985); *Brener v. Becker Paribas Inc.*, 628 F. Supp. 442, 449-50 (S.D.N.Y. 1985).

The Second Circuit's decision in this action, however, contains no analysis of RICO's language or the statute's legislative history. Indeed, the Second Circuit did not conclude that Congress, in enacting RICO, intended to carve out an exception to the Arbitration Act. The Court chose instead to create a judicial exception to the Arbitration Act, concluding that undefined "public policy" considerations barred arbitration of RICO claims. *McMahon*, 788 F.2d at 98-99. In so doing, the Second Circuit relied upon its own decision in *American Safety*, in which it held that "the pervasive public interest in enforcement of the antitrust laws and the nature of the claims that arise in such cases, combine to make . . . antitrust claims . . . inappropriate for arbitration." *Id.* at 827-28.[22]

(United States July 2, 1986); *Washington v. Miller*, 235 U.S. 422, 428 (1914). Because it contains no clear expression of Congressional intention to create an exception to the Arbitration Act, the RICO statute, enacted in 1970, should be construed as consistent with the Arbitration Act, in force since 1925.

[21] Many of the courts that have held private RICO claims arbitrable have based their decisions, in whole or in part, upon the absence of a non-waiver provision in the RICO statute. *See Bale v. Dean Witter Reynolds, Inc.*, 627 F. Supp. 650, 654 (D. Minn. 1986); *Jacobson v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,276 at 91,899 (W.D. Pa. Apr. 19, 1985); *Ross v. Mathis*, 624 F. Supp. at 116-17 & n.6; *Brener v. Becker Paribas Inc.*, 628 F. Supp. 442, 450 (S.D.N.Y. 1985).

[22] To the extent that the Second Circuit's decision in this case is based upon the belief that arbitrators are unable to decide issues of fraud and complicated

(footnote continued)

In relying upon *American Safety*, the Second Circuit in this case failed to heed the mandate of *Mitsubishi*: that if Congress did not find public policy concerns sufficiently persuasive to create an exception to the Arbitration Act for the particular claim in question, then the Arbitration Act's strong public policy considerations must control. Indeed, this Court in *Mitsubishi* expressed skepticism over the validity of *American Safety* in any setting. *See Mitsubishi*, 105 S. Ct. at 3355-60. The Second Circuit's reliance upon *American Safety*'s obvious distrust of arbitration, rather than on any analysis of Congressional intent, thus requires reversal.

2. Civil RICO claims rarely implicate public policy, as they almost always involve simple commercial disputes

Even assuming, however, the continuing vitality of *American Safety*, its rationale is irrelevant to the arbitrability of most civil RICO claims. The vast majority of these claims do not involve public policy any more than do state law claims of fraud, which may be arbitrated. The district courts have come to recognize that "[t]he majority of civil RICO claims today do not impact on the general society or involve vital national interests. . . . " *Bale*, 627 F. Supp. at 654. Commercial disputes that otherwise would involve only claims of breach of contract, securities law violations, or fraud are now framed as RICO claims. *Haroco, Inc. v. American Nat. Bank and Trust Co.*, 747 F.2d 384, 386-87 (7th Cir. 1984), *aff'd*, 105 S. Ct. 3291 (1985) (per curiam); *see also The Supreme Court - Leading Cases*, 99 Harv. L. Rev. 120, 312-13 (1985) (the subject matter of private civil RICO actions is increasingly " 'ordinary' commerical fraud").

This lawsuit is typical of the RICO action today. The respondents' complaint alleges fraud based upon broker

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(footnote continued)

commercial disputes competently and fairly, the decision ignores the long experience of the securities industry in arbitrating the very types of claims that are asserted in RICO complaints. *See supra* at 9 and n.5 and C. Katsoris, *The Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279 (1984).

misrepresentations and "churning" in their accounts; the "racketeering" activity in respondents' RICO claims is nothing more than the alleged misrepresentations and "churning" that form the basis for the fraud claims. This is a classic example of plaintiffs' "Pavlovian inclusion of a RICO claim" in almost every securities lawsuit. *Huss v. Goldman, Sachs & Co.*, No. 86-C-2680 (N.D. Ill. May 13, 1986). As the *Huss* Court noted, plaintiffs in securities cases "not only assert the standard claims under the 1933 and 1934 federal acts, coupled of course with a state blue-sky law claim, but they now invariably also invoke [RICO]."

This type of "racketeering" claim is the rule, rather than the exception. RICO has become "essentially a federal business tort statute." *Bale*, 627 F. Supp. at 654; *see Bob Ladd, Inc.*, 633 F. Supp. at 244 n.l.; *Brener v. Becker Paribas Inc.*, 628 F. Supp. at 450; *West v. Drexel Burnham Lambert, Inc.*, 623 F. Supp. 26, 28-29 (W.D. Wash. 1985). A survey of trial court decisions conducted by the American Bar Association showed that 77% of all civil RICO cases reported involved securities fraud or mail or wire fraud in a commercial setting. *ABA Report* at 55-56. In that same survey, the ABA looked at 270 RICO lawsuits and discovered that broker-dealers were the primary defendants in at least 40 of the cases, banks were the primary defendants in 32 cases, and lawyers and accountants were defendants in 20 cases. *ABA Report* at 35 n.41. Another survey of 132 decisions in civil RICO cases indicated that 63 cases arose out of securities transactions or commodities trading, and another 38 cases arose out of commercial or contractual disputes. *AICPA White Paper* at 14-15.[23]

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[23] RICO is currently, and very frequently, being utilized for purposes far afield from those envisioned by Congress. Not only has civil RICO been used against securities broker-dealers, commodities traders, investment bankers, commercial banks, financing institutions, insurance companies, manufacturing concerns, accounting firms and attorneys, *see ABA Report* at 35 & n.41, it has also been used outside of the commercial world. *See, e.g., Martin-Trigona v. D'Amato & Lynch*, 539 F. Supp. 533 (S.D.N.Y. 1983) (legal assistance provided to *pro se* defendants in another action); *Pit Pros, Inc. v. Wolf*, 554 F. Supp. 284 (N.D. Ill. 1983) (landlord-tenant dispute); *Erlbaum v. Erlbaum*, [1982] Fed. Sec. L. *(footnote continued)*

Many district courts with first-hand experience with RICO claims have concluded that such disputes can be resolved by arbitrators with no risk to public policy concerns. *See, e.g., Steinberg v. The Illinois Co.*, No. 85-C-7131 (N.D. Ill. May 15, 1986); *Sacks*, Fed. Sec. L. Rep. ¶ 92,429 at 92,642; *see also West*, 623 F. Supp. at 29 ("there is no reason to pay lip service to a policy that justifies only a tiny minority of RICO cases").

Indeed, it is highly unlikely that the enforceability of arbitration agreements will ever arise in the types of cases that RICO was meant to address. A "contract" between "a shopkeeper [who] is approached by an organized crime henchman for protection money . . . undoubtedly would not contain an agreement to arbitrate." *Ross v. Mathis*, 624 F. Supp. at 117 n.6.[24] There is thus no reason to hold that the public policy underlying RICO prevents civil RICO claims from being arbitrated. The Second Circuit's decision to the contrary should be reviewed and reversed.

(footnote continued)

Rep. (CCH) ¶ 98,772 (E.D. Pa. July 13, 1982) (marital squabble); *Congregation Beth Yitzhok v. Briskman*, 566 F. Supp. 555 (E.D.N.Y. 1983) (religious dispute over control of congregation property); *King v. Lasher*, 572 F. Supp. 1377 (S.D.N.Y. 1983) (will contest).

[24] It is unlikely that claims involving the type of activity Congress intended RICO to address would be arbitrated for the additional reason that, under the Uniform Code of Arbitration, securities regulatory organizations have the right to decline the use of their arbitration facilities where the dispute "is not a proper subject matter for arbitration." Uniform Code of Arbitration § 1(b), N.A.S.D. Manual (CCH) § 3712(b). If this Court reversed the Second Circuit's *per se* rule, the lower courts could fashion a rule, such as the court applied in *West v. Drexel Burnham Lambert, Inc.*, 623 F. Supp. at 29, that the policy of enforcing arbitration agreements should prevail if the RICO claim "touches upon no great societal or public interest."

CONCLUSION

For all the foregoing reasons, petitioners respectfully request that this Court issue a writ of certiorari in this case to review the decision of the United States Court of Appeals for the Second Circuit.

DATED: NEW YORK, NEW YORK
July 14, 1986

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APPENDIX

APPENDIX A

STATUTORY AND REGULATORY PROVISIONS INVOLVED

United States Arbitration Act

9 U.S.C. § 2:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 3:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

Securities Act of 1933

Section 12(2), 15 U.S.C. § 77 l (2):

> Any person who –
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> * * *
>
> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of

said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 14, 15 U.S.C. § 77n:

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

Securities Exchange Act of 1934

Section 10, 15 U.S.C. § 78j(b):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national

securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 29(a), 15 U.S.C. § 78 cc(a):

Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

Racketeer Influenced and Corrupt Organizations Act

18 U.S.C. § 1962:

(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code, to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern or racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsections (a), (b), or (c) of this section.

18 U.S.C. § 1964(c):

Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

Securities and Exchange Commission Regulation

Rule 10b-5, 17 C.F.R. § 240.10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 806, 894—August Term 1985

(Argued March 3, 1986 Decided April 16, 1986)

Docket Nos. 85-7844, 85-7846

EUGENE MCMAHON, JULIA MCMAHON, individually and as Trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Plaintiffs-Appellants-Cross-Appellees,

—v.—

SHEARSON/AMERICAN EXPRESS, INC., and MARY ANN MCNULTY,

Defendants-Appellees-Cross-Appellants.

Before:

FEINBERG, *Chief Judge*,
and TIMBERS and NEWMAN, *Circuit Judges*.

Appeal from an order entered September 25, 1985 in the Southern District of New York, Lloyd F. MacMahon, *District Judge*, requiring broker's customers to arbitrate claims under the Securities Exchange Act of 1934 and pendent state law claims pursuant to customer agreements containing an arbitration clause, and staying litigation of an alleged RICO violation claim pending arbitration.

Affirmed in part; reversed and remanded in part.

THEODORE G. EPPENSTEIN, New York, N.Y. (Madelaine Eppenstein, and Eppenstein & Eppenstein, New York, N.Y., on the brief), *for appellants*.

THEODORE A. KREBSBACH, New York, N.Y. (Harry D. Frisch and Shearson Lehman Brothers Inc., New York, N.Y., on the brief), *for appellees*.

WILLIAM J. FITZPATRICK and GERARD J. QUINN, New York, N.Y., submitted a brief *for the Securities Industry Association, Inc., amicus curiae*.

TIMBERS, *Circuit Judge*:

Eugene McMahon and Julia A. McMahon ("appellants"), individually and as trustees for various pension and profit-sharing plans, appeal from that part of an order entered September 25, 1985 in the Southern District of New York, Lloyd F. MacMahon, *District Judge*, 618 F. Supp. 384, which required appellants to arbitrate their claims against Shearson/American Express, Inc. and its registered representative, Mary Ann McNulty, ("Shearson") for alleged violations of the Securities Exchange Act of 1934 ("1934 Act") and state law claims of fraud and breach of fiduciary duties. Shearson appeals from that part of the order holding not arbitrable appellants' claim under the Racketeer Influenced Corrupt Organizations Act, 18 U.S.C. § 1962(c) (1982) ("RICO"). The district court stayed litigation of the RICO claim pending arbitration of the securities law and state law claims.

For the reasons set forth more fully below, under the settled law of this Circuit we hold that the district court erred in holding arbitrable appellants' claims under § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1985). The district court, however, was correct in holding the RICO claim to be non-arbitrable. Applying the decision of the Supreme Court in *Dean Witter Reynolds, Inc.* v. *Byrd*, 105 S. Ct. 1238 (1985), we hold that arbitration of the pendent state law claims is required, even though bifurcated proceedings may result.

In short, we affirm in part, and reverse and remand in part.

I.

The facts and prior proceedings are simple and straightforward.

Appellants, individually and as trustees for various pension and profit-sharing plans, commenced this action against Shearson, a brokerage firm, and its registered representative who handled appellants' accounts. Appellants alleged that the registered representative of Shearson, with its knowledge, had violated § 10(b) of the 1934 Act and Rule 10b-5 by churning appellants' accounts, making false statements and omitting material facts from the advice given appellants. Appellants also alleged a RICO claim and state law claims for fraud and breach of fiduciary duties.

On June 15, 1982 Julia McMahon entered into a customer agreement with Shearson which contained an arbitration clause providing in relevant part as follows:

> "Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I may elect."

Relying on this clause, Shearson moved, pursuant to § 3 of the United States Arbitration Act, 9 U.S.C. § 3 (1982), to compel arbitration of all of appellants' claims. In the alternative, Shearson moved to dismiss the complaint for failure to state a claim upon which relief could be granted and on other grounds, none of which is relevant in view

of the district court's disposition of the motion to compel arbitration.

The district court rejected appellants' assertions that the customer agreement containing the arbitration clause is a contract of adhesion, that fraud is not an arbitrable issue, and that Shearson had waived its right to arbitrate. The court ordered arbitration of the § 10(b) and Rule 10b-5 claims, reasoning that recent Supreme Court decisions cast doubt on holding claims under the 1934 Act to be not arbitrable. In view of the important federal policies inherent in the enforcement of RICO by the federal courts, however, the court stayed litigation of that claim pending arbitration. The court ordered arbitration of the state law claims.

We shall examine first the district court's decision that the claims under § 10(b) and Rule 10b-5 are arbitrable. We shall then address the arbitrability of the RICO claim and state law claims.

II.

We turn first to the district court's disposition of appellants' 1934 Act claims.

We hold that the district court's decision that appellants' claims under § 10(b) and Rule 10b-5 are arbitrable is an unwarranted departure from the settled law of this Circuit and must be reversed.

In *Wilko* v. *Swan*, 346 U.S. 427 (1953), the Supreme Court held that, despite the United States Arbitration Act, 9 U.S.C. § 1 *et seq.*, claims arising under § 12(2) of the Securities Act of 1933 ("1933 Act") are not arbitrable. In reaching this result, the Court pointed out that an agreement to arbitrate claims is void under § 14 of the

1933 Act as a stipulation binding the securities customer to waive compliance with a provision of the Act.[1] The provision referred to is the aggrieved party's right to select the judicial forum under § 22(a) of the 1933 Act.

As our late colleague, Judge Friendly, noted in *Colonial Realty* v. *Bache & Co.*, 358 F.2d 178, 183 n.5 (2 Cir.), *cert. denied*, 385 U.S. 817 (1966), the non-waiver provision of § 14 of the 1933 Act has an almost identical counterpart in § 29(a) of the 1934 Act.[2] In view of *Wilko* and the similarity of the non-waiver provisions of the 1933 and 1934 Acts, we consistently have held that § 10(b) and Rule 10b-5 claims are not arbitrable.[3] In *Greater Continental Corp.* v. *Schechter*, 422 F.2d 1100, 1103 (2 Cir. 1970), we observed that alleged violations of Rule 10b-5 were "properly litigated in the courts where a

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1. Section 14 of the Securities Act of 1933, 15 U.S.C. § 77n (1982), provides:

> "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."

2. Section 29(a) of the Securities Act of 1934, 15 U.S.C. § 78cc(a) (1982), provides:

> "Any condition, stipulation or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

3. Following *Wilko*, several other courts of appeals likewise have held that claims arising under the 1934 Act are not arbitrable. *E.g.*, *De Lancie* v. *Birr, Wilson & Co.*, 648 F.2d 1255, 1258-59 (9 Cir. 1981); *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1039 (6 Cir. 1979); *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Moore*, 590 F.2d 823, 827-29 (10 Cir. 1978); *Weissbuch* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831, 833-35 (7 Cir. 1977); *Sibley* v. *Tandy Corp.*, 543 F.2d 540, 543 (5 Cir. 1976), *cert. denied*, 434 U.S. 824 (1977); *Ayres* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536 (3 Cir.), *cert. denied*, 429 U.S. 1010 (1976).

complete record is kept of the proceedings and findings and conclusions are made." We also pointed out the similarity between § 14 of the 1933 Act and § 29(a) of the 1934 Act. *Id.* In *Allegaert* v. *Perot*, 548 F.2d 432, 436-38 (2 Cir.), *cert. denied*, 432 U.S. 910 (1977), we reiterated the view that claims under § 10(b) of the 1934 Act are not arbitrable, noting that the broad policy questions involved in securities law claims require a judicial forum for resolution of disputes. Again in *AFP Imaging Corp.* v. *Ross*, 780 F.2d 202, 205 (2 Cir. 1985), we held that, in an action which alleged violations of § 10(b) and Rule 10b-5, an arbitration clause in the contract was "unenforceable under the law of this Circuit".

Despite the settled law of this Circuit that claims under § 10(b) and Rule 10b-5 of the 1934 Act are not arbitrable, Shearson, speculating as to what the Supreme Court may do with our settled law, invites us to overrule our own precedents. We decline the invitation.

The district court, in addition to emphasizing the strong national policy favoring arbitration, focused on the Supreme Court's decisions in *Dean Witter Reynolds, Inc.* v. *Byrd*, 105 S. Ct. 1238 (1985), and *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506 (1974). In *Byrd*, since the securities broker had sought to compel arbitration of only pendent state claims—not claims arising under the 1934 Act—the Court declined to reach the issue of whether § 10(b) and Rule 10b-5 claims are arbitrable. 105 S. Ct. at 1240 n.1. Nevertheless, various courts, in holding that § 10(b) and Rule 10b-5 claims are arbitrable, have sought refuge in Justice White's concurring opinion in *Byrd*, 105 S. Ct. at 1244. Justice White stated that *Wilko's* reasoning cannot be "mechanically transplanted" to the 1934 Act. *Id.* While acknowledging the similarity

between § 14 of the 1933 Act and § 29(a) of the 1934 Act, Justice White reasoned that the narrower jurisdiction under the 1934 Act and the implied, rather than express, causes of action under § 10(b) and Rule 10b-5 distinguished claims under the 1934 Act from those arising under the 1933 Act. *Id.* Both the *Byrd* majority and Justice White's concurring opinion acknowledged that *Scherk* v. *Alberto-Culver Co.*, *supra*, 417 U.S. at 513-15, cast some doubt on the applicability of *Wilko* to claims under § 10(b) or Rule 10b-5. 105 S. Ct. at 1240 n.1; 105 S. Ct. at 1244.[4] The Supreme Court in *Byrd*, however, referred to the *Scherk* decision as follows:

> "The [*Scherk*] Court did not, however, hold that *Wilko* would not apply in the context of a § 10(b) or Rule 10b-5 claim, and *Wilko* has retained considerable vitality in the lower federal courts. Indeed, numerous District Courts and Courts of Appeals have held that the *Wilko* analysis applies to claims arising under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and that agreements to arbitrate such claims are therefore unenforceable."

105 S. Ct. at 1240 n.1. (Citations omitted, being among those included in note 3, *supra*).

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4. Indeed, some courts within this Circuit have interpreted dicta in *Scherk* and *Byrd* as authority for holding such claims to be arbitrable. *E.g.*, *Intre Sport Ltd.* v. *Kidder, Peabody & Co.*, 625 F. Supp. 1303 (S.D.N.Y. 1985); *Finkle & Ross* v. *A.G. Becker Paribas, Inc.*, 622 F. Supp. 1505 (S.D.N.Y. 1985); *Jarvis* v. *Dean Witter Reynolds, Inc.*, 614 F. Supp. 1146 (D. Vt. 1985); *Brener* v. *Becker Paribas, Inc.*, 84 Civ. 5872 (S.D.N.Y. Dec. 31, 1985); *Ilan* v. *Shearson/American Express, Inc.*, 83 Civ. 9319 (S.D.N.Y. Dec. 23, 1985); *Johnson* v. *Kidder, Peabody & Co.*, 85 Civ. 178 (N.D.N.Y. July 30, 1985).

Other courts have continued to follow the settled law of this Circuit, holding claims under § 10(b) and Rule 10b-5 not arbitrable. *E.g.*, *Leone* v. *Advest, Inc.*, 624 F. Supp. 297 (S.D.N.Y. 1985); *Weizman* v. *Adornato*, 84 Civ. 3603 (E.D.N.Y. April 25, 1985).

In the instant case, the district court focused on the allegations of churning and misrepresentation centered on particular securities accounts and held inapplicable the broad policy concerns which this Circuit has recognized in holding 1934 Act claims not arbitrable. While a churning claim by its nature is limited to the specific accounts in question, such claims also reflect the public interest and are important in their deterrent effect. The securities laws generally, and the implied causes of action which the courts have recognized, are designed to protect the public, and particularly the less sophisticated investor. Moreover, this Circuit has not recognized an exception to the non-arbitrability of securities law claims in circumstances other than disputes between member firms of the stock exchanges. *E.g.*, *Coenen* v. *R. W. Pressprich & Co.*, 453 F.2d 1209 (2 Cir.), *cert. denied*, 406 U.S. 949 (1972); *Axelrod & Co.* v. *Kordich, Victor & Neufeld*, 451 F.2d 838 (2 Cir. 1971). We see no justification for carving out an exception to our non-arbitrability precedents for individual claims of churning and misrepresentation.

In short, the similarity of the non-waiver provisions, § 14 of the 1933 Act and § 29(a) of the 1934 Act, as well as the strong public policy concerns inherent in the securities laws and the legislative history that preceded their enactment, support the compelling need for a judicial forum in the resolution of securities law disputes. Although *Scherk* and *Byrd* may cast some doubt on whether the Supreme Court, if presented with the issue, would hold claims under § 10(b) and Rule 10b-5 to be non-arbitrable, it would be improvident for us to disregard clear judicial precedent in this Circuit based on mere speculation. We think that the orderly administration of justice will be best served if we as one of the inferior

courts follow Supreme Court precedent and adhere to the settled law of this Circuit, and a fortiori the district courts should do likewise.

III.

We turn next to the district court's disposition of appellants' RICO claim.

Pointing to the important federal policies inherent in the enforcement of RICO by the federal courts, the district court stayed litigation of the RICO claim pending arbitration of the state law claims and the securities law claims. The RICO claim was thus placed on the suspense docket pending the outcome of arbitration of the other claims.

In other contexts, we have recognized the inappropriateness of the United States Arbitration Act when strong public policy considerations are involved. In *American Safety Equipment* v. *J.P. Maguire* 391 F.2d 821 (2 Cir. 1968), we stated that "[a] claim under the antitrust laws is not merely a private matter. The Sherman Act is designed to promote the national interest in a competitive economy; thus, the plaintiff asserting his rights under the Act has been likened to a private attorney-general who protects the public's interest." 391 F.2d at 826. We hold that there are comparable concerns inherent in the enforcement of RICO claims.

The Supreme Court has recognized that arbitration is appropriate in *international* antitrust disputes because of concerns for international comity, respect for the capacities of foreign and transnational tribunals, and the need for predictability in the international commercial system. *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth,*

Inc., 105 S. Ct. 3346 (1985). The reasoning of our decision in *American Safety*, however was not disputed in *Mitsubishi*, "as applied to agreements to arbitrate arising from domestic transactions." 105 S. Ct. at 3355. Enforcement of the RICO statute is particularly appropriate in a judicial forum because of strong policy concerns, the need for development of the record, and judicial clarification and resulting consistency in resolving disputes under this relatively new statute.

The district court had placed the RICO claim on the suspense docket because the arbitrable claims "permeate the case, and the validity of the RICO claim is uncertain at this stage of the litigation." 618 F. Supp. at 389. Since we have held that the securities law claims are not arbitrable, it is now appropriate that the securities law and RICO claims be litigated together since they arise out of the same transaction.[5]

IV.

Finally, this brings us to the district court's disposition of appellants' pendent state law claims.

In addition to the claims that Shearson had violated § 10(b), Rule 10b-5, and RICO, appellants' amended complaint alleged state law claims for common law fraud and breach of fiduciary duties. The district court granted Shearson's motion to compel arbitration of these pendent state law claims as well as the securities law claims.

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5. Appellants suggest that the district court's denial of arbitration of the RICO claim was not an appealable interlocutory order under 28 U.S.C. § 1292(a) (1982). We disagree. *See Ettelson* v. *Metropolitan Life Insurance Co.*, 317 U.S. 188, 191 (1942); *Enelow* v. *New York Life Insurance Co.*, 293 U.S. 379, 383 (1935); *Poriss* v. *Aacon Auto Transport, Inc.*, 685 F.2d 56, 59-60 (2 Cir. 1982).

Under the Supreme Court's decision in *Dean Witter Reynolds, Inc.* v. *Byrd, supra*, these state law claims must be sent to arbitration where there is an enforceable arbitration clause and where a party's motion to compel arbitration encompasses the state law claims, as here.[6] *See also AFP Imaging Corp.* v. *Ross, supra*, 780 F.2d at 205. The Court's language in *Byrd* is unequivocal.

> "[T]he Arbitration Act requires district courts to compel arbitration of pendent arbitrable claims when one of the parties files a motion to compel, even where the result would be the possibly inefficient maintenance of separate proceedings in different forums."

105 S. Ct. at 1241. The Court also recognized that such bifurcated proceedings could result where securities or antitrust violations are alleged. 105 S. Ct. at 1241 n.5. We hold that the district court correctly held that the pendent state claims were arbitrable. Despite the potential inefficiency of bifurcated proceedings, we are obliged under *Byrd* to affirm that part of the district court's order compelling arbitration of the pendent state law claims.[7]

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6. Appellants challenge the arbitrability of their claims against Shearson on numerous grounds. In view of our rulings on the securities and RICO claims, these arguments are not relevant to the litigation of the disputes under federal law but they do require brief examination since, generally, state law claims for fraud and breach of fiduciary duties are arbitrable if there is a valid arbitration clause. In the instant case, the district court found that the elements for compelling arbitration were present, *i.e.*, an agreement to arbitrate, arbitrable claims, and the absence of a waiver. We find no reason to disturb the district court's threshold determination that an enforceable arbitration clause was in effect. While we hold the federal claims here are not within the scope of the arbitration clause, we also hold that the court correctly compelled arbitration of the state law claims for fraud and breach of fiduciary duties..

7. Of course, if appellants, upon remand of this case to the district court, should withdraw their pendent state law claims, that would

V.

To summarize:

We hold that the district court erred in departing from this Circuit's precedents in granting Shearson's motion to compel arbitration of the claims alleging a violation of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. The district court properly denied the motion to compel arbitration of the RICO claim because of the inherent public interest underlying that cause of action and the need for examining and resolving such disputes in the federal courts. The district court properly compelled arbitration of the pendent state law claims.[8]

Affirmed in part; reversed and remanded in part.

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result in no claims left to be arbitrated. All remaining claims would be litigated in the federal court. And bifurcated proceedings would be avoided. *See AFP Imaging Corp.* v. *Ross*, *supra*, 780 F.2d at 205.

8. Though the applicability of *Wilko* v. *Swan*, *supra*, to issues arising under § 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 is settled in this Circuit, it would nonetheless have been helpful if the Securities and Exchange Commission had volunteered an amicus brief to inform us of its views. Without any request, the Commission rendered substantial help with respect to corresponding questions under the Securities Act of 1933 in *Wilko* v. *Swan*, *supra*—both in this Court, 201 F.2d at 440, 441-42, 445, and in the Supreme Court, 346 U.S. at 427, 428, 440.

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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EUGENE McMAHON and JULIA McMAHON, individually and as Trustees of The David J. Hodder & Son, Inc. Employee Pension Plan; The David J. Hodder & Son, Inc. Profit Sharing Plan; The Laurie Funeral Home, Inc. Employee Pension Plan; The Laurie Funeral Home Profit Sharing Plan,

Plaintiffs,

– against –

SHEARSON/AMERICAN EXPRESS, INC. and MARY ANN McNULTY,

Defendants.

----------X

84 Civ. 3331 (LFM)

OPINION

APPEARANCES:

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MacMahon, District Judge.

Defendants move, pursuant to 9 U.S.C. § 3 (1970), for an order staying this action pending arbitration, or, in the alternative, pursuant to Rules 12(b)(6), 12(f) and 9(b), Fed.R.Civ.P., for an order dismissing plaintiffs' amended complaint for failure to state a claim upon which relief can be granted.

Facts

This is an action brought by plaintiffs, Eugene and Julia A. McMahon, individually and as trustees of the David J. Hodder & Son, Inc. Employee Pension Plan; the David J. Hodder & Son, Inc. Profit Sharing Plan; the Laurie Funeral Home, Inc. Employee Pension Plan; and the Laurie Funeral Home, Inc. Profit Sharing Plan ("the trusts"), against Shearson/American Express, Inc. ("Shearson"), a brokerage firm, and Mary Ann McNulty ("McNulty"), a registered representative who was responsible for plaintiffs' accounts at Shearson.

On June 15, 1982, in connection with the opening of her joint account at Shearson, Julia McMahon entered into a customer's agreement which contained the following arbitration provision:

> "Unless unenforceable due to federal or state law, *any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration* in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I may elect. * * * Judgment upon any award rendered by the arbitrators may be entered in any court having jurisdiction thereof (emphasis added)."[1]

On October 26, 1984, plaintiffs filed an amended complaint, alleging, in essence, that McNulty, with the knowledge and consent of Shearson, (1) engaged in "churning" or the fraudulent and wilful practice of trading extensively solely to maximize commissions, (2) intentionally and recklessly violated Section 10(b)

of the Securities Exchange Act of 1934 ("the 1934 Act")[2] and Rule 10b-5 promulgated thereunder, by making false statements and omitting material facts from the advice given plaintiffs, and (3) violated the Racketeer Influenced and Corrupt Organization Act of 1974 ("RICO").[3]

Defendants move for an order compelling plaintiffs to arbitrate their state law claims, as well as their claims under Section 10(b) of the 1934 Act and RICO. Alternatively, defendants move to dismiss the amended complaint on the following grounds: (1) failure to comply with the pleading requirements of Rule 9(b), Fed.R.Civ.P.; (2) lack of subject matter and pendent jurisdiction; (3) absence of an implied private cause of action for alleged violation of the rules of the New York Stock Exchange, Inc. and the National Association of Securities Dealers, Inc.; (4) failure to state a claim under RICO; and (5) unavailability of punitive damages.

Discussion

The United States Arbitration Act,[4] "reversing centuries of judicial hostility to arbitration agreements, was designed to allow parties to avoid 'the costliness and delays of litigation,' and to place arbitration agreements 'upon the same footing as other contracts . . . . ' "[5] Accordingly, the Act provides:

> "A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy arising out of such contract or transactions . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

The customer's agreement, entered into between Shearson and McMahon, contains McMahon's agreement to arbitrate "any controversy arising out of or relating to" her securities at Shearson or to any "transactions" with Shearson for her. Defendants have therefore petitioned this court for an order compelling arbitration of this action.[6]

To prevail on a motion to compel arbitration, a party needs

only to establish (1) the existence of an agreement to arbitrate, (2) arbitrable claims, and (3) no waiver of the right to arbitrate.[7] Plaintiffs contend that the aribtration provision in the customer's agreement is not enforceable because (1) the customer's agreement is a contract of adhesion, (2) fraud is not an arbitrable issue, and (3) defendants have waived their right to arbitrate.

We find that plaintiffs' arguments are wholly unconvincing. First, it is well settled that one who signs a contract, in the absence of fraud or misconduct by another contracting party, is conclusively presumed to know its contents and to assent to them.[8] Julia McMahon signed the customer's agreement and has not demonstrated that it was entered into under fraud or duress. Arbitration clauses are routinely upheld by the courts, and, given plaintiffs' sizeable investment, there is nothing to indicate that they were without bargaining power. Moreover, in *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402-404 (1967), the Supreme Court held that "a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud." Therefore, even if we were to assume that the customer's agreement was fraudulently induced, the breadth of the arbitration provision would mandate that the issue of fraud in the inducement also be referred to arbitration.

Second, plaintiffs argue that their allegations of common law fraud are not arbitrable because the arbitration provision does not contemplate an action in tort. This argument is without merit. The substance of plaintiffs' amended complaint, that defendants excessively "churned" their securities accounts and fraudulently represented the status of the accounts, is clearly within the scope of the arbitration clause as it arose from and relates to plaintiffs' accounts at Shearson. Moreover, in *Dean Witter Reynolds Inc.* v. *Byrd*, ____ *U.S.* ____, 105 S.Ct. 1238 (1985), the Supreme Court recently held that a district court is required to compel arbitration of state law fraud claims where the parties entered into an arbitration agreement similar to the one presented here.

Finally, plaintiffs contend that defendants waived their right to arbitrate this action when they commenced a state court action against plaintiffs. We find that, since the prior state court

proceeding involves issues only tangentially related to those at stake here, that proceeding has no bearing on this action and certainly no effect on plaintiffs' agreement to arbitrate. We therefore conclude that the federal Arbitration Act[9] mandates that we compel arbitration of all arbitrable claims arising out of plaintiffs' accounts or related transactions at Shearson.[10]

The remaining question for us is which of plaintiffs' claims are "arbitrable." The state law fraud claims are clearly arbitrable under the Supreme Court's decision in *Byrd*. The RICO claim is not arbitrable because of the important federal policies inherent in the enforcement of RICO by the federal courts.[11] Claims based on violations of the federal securities laws have been considered to be non-arbitrable based on the doctrine enunciated in *Wilko* v. *Swan*, 346 U.S. 427 (1953). The validity of the *Wilko* doctrine, as applied to cases involving transactions outside the protection of the Securities Act of 1933 ("the 1933 Act"), however, is clearly suspect. The arbitrability of plaintiffs' Section 10(b) claims under the 1934 Act, therefore, merits some discussion.

In *Wilko*, the Supreme Court held that an agreement to arbitrate claims that arise under Section 12(2) of the 1933 Act[12] was not enforceable. The Court relied on three interconnected statutory provisions: (1) Section 14 of the 1933 Act which voids any "stipulation . . . binding any person acquiring any security to waive compliance with any provision" of the 1933 Act; (2) Section 12(2) which creates "a special right to recover for misrepresentation which differs substantially from the common law action;" and (3) Section 22 which allows suits in any state or federal court of competent jurisdiction and provides for nationwide service.[13] The Court concluded that an agreement to arbitrate was a stipulation waiving the right to seek a judicial remedy and therefore was void.[14]

Several lower federal courts have assumed that *Wilko* applies to 1934 Act claims and have grouped claims under Section 12(2) of the 1933 Act, as well as claims under Section 10(b) of the 1934 Act, under the umbrella of non-arbitrable claims.[15]

The Supreme Court, however, first expressed reservations about the propriety of applying *Wilko* to claims arising under the 1934 Act in *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506 (1974). These

reservations were recently reiterated in *Byrd*, *supra*, where the Court again "questioned the applicability of *Wilko* to a claim arising under Section 10(b) of the 1934 Act or under Rule 10b-5 because the provisions of the 1933 and 1934 Acts differ and because, unlike Section 12(2) of the 1933 Act, Section 10(b) of the 1934 Act does not give rise to a private cause of action."[16] The *Byrd* court declined to resolve the applicability of *Wilko* to Section 10(b) claims because the question was not properly before the Court. Justice White, however, in his concurring opinion, stated that "*Wilko's* reasoning cannot be mechanically transplanted to the 1934 Act" and cast substantial doubt on the contrary holdings of lower federal courts.[17] He emphasized the salient distinctions between Sections 12(2) and 10(b):

> "While § 29 of that Act, 15 U.S.C. § 78cc(a), is equivalent to § 14 of the 1933 Act, counterparts of the other two provisions are imperfect or absent altogether. Jurisdiction under the 1934 Act is narrower, being restricted to the federal courts. 15 U.S.C. § 78aa. More important, the cause of action under § 10(b) and Rule 10b-5, involved here, is implied rather than express. See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380, and nn. 9-10, 103 S.Ct. 683, 686-87, and nn. 9-10, 74 L.Ed.2d 548 (1983). The phrase 'waive compliance with *any provision of this chapter*,' 15 U.S.C. § 78cc(a) (emphasis added), is thus literally inapplicable. Moreover, *Wilko's* solicitude for the federal cause of action—the 'special right' established by Congress, 346 U.S., at 431, 74 S.Ct., at 184—is not necessarily appropriate where the cause of action is judicially implied and not so different from the common law action."[18]

The only time the Supreme Court was faced with the issue of whether *Wilko* applied to Section 10(b) claims, albeit in the context of an international contract, the Court held that the claims were subject to the parties' agreement to arbitrate.[19] The Court noted that "a colorable argument could be made that even the semantic reasoning of the *Wilko* opinion does not control the

case before us," as "[t]here is no statutory counterpart of § 12(2) in the [1934 Act], and neither § 10(b) . . . nor Rule 10b-5 speaks of a private remedy. . . ."[20] Similarly, we entertain grave doubts about the legal correctness of overriding the parties' express agreement concerning arbitration of all controversies in the name of protecting federal jurisdiction over implied rights of action.

Based on Justice White's concurring opinion in *Byrd*, the reservations by the Supreme Court in *Scherk* v. *Alberto-Culver Co.*, *supra*, and the strong national policy favoring the enforcement of arbitration agreements articulated in *Moses H. Cone Memorial Hospital* v. *Mercury Const. Corp.*, 460 U.S. 1 (1983), several district courts have held that the *Wilko* doctrine does not extend to Section 10(b) claims.[21]

Although there exists precedent in this circuit holding that Section 10(b) claims are not arbitrable,[22] there is doubt that these decisions retain viability in light of the Supreme Court's ruling in *Byrd*. In *Allegaert* v. *Perot*, 548 F.2d 432 (2d Cir. 1977), the trustrees of a bankrupt securities brokerage firm sued four individuals, several corporate members of the New York Stock Exchange and the Exchange itself, alleging violations of the Bankruptcy Act,[23] the 1934 Act and various state corporate laws. In deciding whether to compel arbitration of the alleged violations of the anti-fraud provisions of the securities laws, the court examined "the public interest in the dispute, the degree to which the nature of the evidence made the judicial forum preferable to arbitration, and the extent to which the agreement was a product of free choice."[24] Pointing out that the case was "a claim of wholesale fraud" brought on behalf of hundreds of creditors, the court determined that the claim was imbued with strong public interest and protective public policy considerations which were inappropriate for enforcement by arbitration.[25]

We are not presented here with claims involving fraud, nor industry-wide practices which may tend to ensnare an unsuspecting public.[26] Plaintiffs' claim is simply that a single securities representative "churned" their accounts and made certain

misrepresentations concerning the status of those accounts. Such a dispute over the management of an account neither raises broad issues of policy nor involves widespread industry practices and, therefore, touches none of the concerns at stake in *Allegaert* which mandate a judicial forum.

We note the distinction between the 1933 Act and the 1934 Act, as well as the strong national policy favoring arbitration, and thereby accept *Byrd's* invitation to compel the parties' compliance with their express contractual obligations concerning arbitration. We consequently hold that the *Wilko* doctrine should not be extended to plaintiffs' Section 10(b) claims.[27] We do not find that all Section 10(b) claims, no matter what their factual underpinnings, are arbitrable, but only that this particular claim relating to the management of a securities account is appropriate for resolution by arbitration.[28] The non-arbitrable RICO claim shall be stayed pending arbitration of the common law and securities fraud claims. This stay is appropriate where the arbitrable claims "permeate" the case, and the validity of the RICO claim is uncertain at this early stage of the litigation.[29]

Accordingly, defendants' motions are granted to the extent that this court orders arbitration of all of plaintiffs' claims, except their claim brought under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1962(c) (1982), the litigation of which is temporarily stayed pending arbitration. This action is placed on the suspense docket pending the outcome of arbitration.

So ordered.

Dated: New York, N. Y.
September 25, 1985

/s/ Lloyd F. MacMahon
LLOYD F. MACMAHON
United States District Judge

FOOTNOTES

1. Customer's Agreement ¶ 13.

2. 15 U.S.C. § 78j(b) (1981).

3. 18 U.S.C. § 1962(c) (1982).

4. 9 U.S.C. §§ 1 *et seq.* (1970).

5. *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-511 (1974), *citing* H.R. Rep. No. 96, 68th Cong., 1st Sess., 1, 2 (1924).

6. 9 U.S.C. § 3 (1970).

7. *Bigge Crane & Rigging Co.* v. *Docutel Corp.*, 371 F. Supp. 240 (E.D.N.Y. 1973).

8. *Fustok* v. *Conticommodity Services, Inc.*, 577 F. Supp. 852, 856 (S.D.N.Y. 1984).

9. 9 U.S.C. § 3 (1970).

10. *Dean Witter Reynolds Inc.* v. *Byrd*, ____ U.S. ____, 105 S.Ct. 1238 (1985).

11. *See S.A. Mineracao da Trindade-Samitri* v. *Utah Int'l*, 576 F. Supp. 566, 574-576 (S.D.N.Y. 1983).

12. 15 U.S.C. § 77 1 (2) (1981).

13. *Wilko* v. *Swan*, 346 U.S. 427, 431, 434-435 (1953); 15 U.S.C. §§ 77n, 77 1 (2), 77v (1981). *See also Dean Witter Reynolds Inc.* v. *Byrd*, *supra* (White, J., *concurring*).

14. *Wilko* v. *Swan*, *supra*, 346 U.S. at 434-435.

15. *See, e.g., DeLancie* v. *Birr, Willson & Co.*, 648 F.2d 1255, 1258-59 (9th Cir. 1981); *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Moore*, 590 F.2d 823, 827-829 (10th Cir. 1978); *Allegaert* v. *Perot*, 548 F.2d 432 (2d Cir. 1977).

16. *Dean Witter Reynolds Inc.* v. *Byrd, supra*, ____ U.S. ____, 105 S.Ct. at 1240 n.l.

17. *Dean Witter Reynolds Inc.* v. *Byrd, supra* (White, J., *concurring*), ____ U.S. ____, 105 S.Ct. at 1243.

18. *Id.*, ____ U.S. ____, 105 S.Ct. at 1244

19. *Scherk* v. *Alberto-Culver Co., supra.*

20. *Id.*, 417 U.S. at 513.

21. *See Raiford* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 83-685A (N.D. Ga. May 16, 1985); *Gregory* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 84-1647 (M.D. Fla. March 9, 1985); *Greenstein* v. *First Biscayne Corp.*, No. 82-0584 (S.D. Fla. May 16, 1985); *Mann* v. *Foster & Marshall*, No. C84-925D (W.D. Wash. May 24, 1985).

22. *See, e.g., Allegaert* v. *Perot, supra.*

23. 11 U.S.C. §§ 701 *et seq.* (1979).

24. *Allegaert* v. *Perot, supra*, 548 F.2d at 436.

25. *Id.*, 548 F.2d at 436-38.

26. *See Greater Continental Corp.* v. *Schechter*, 422 F.2d 1100, 1103 (2d Cir. 1970).

27. *Finn* v. *Davis*, 610 F. Supp. 1079 (S.D. Fla. 1985); *Wells* v. *Oppenheimer & Co.*, 106 F.R.D. 258 (S.D.N.Y. 1985).

28. *Finn* v. *Davis*, *supra*.

29. *See S.A. Mineracao da Trindade-Samitri* v. *Utah Int'l*, *supra*, 566 F. Supp. at 576.

APPENDIX D

JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT, ENTERED ON APRIL 16, 1986

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the sixteenth day of April one thousand nine hundred and eighty-six

Present: HON. WILFRED FEINBERG,
CHIEF JUDGE,
HON. WILLIAM H. TIMBERS,
HON. JON O. NEWMAN,
Circuit Judges,

EUGENE McMAHON, JULIA McMAHON, individually and as Trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Plaintiffs-Appellants-Cross-Appellees,

—V—

SHEARSON /AMERICAN EXPRESS, INC., and MARY ANN McNULTY,

Defendants-Appellees-Cross-Appellants.

Docket Nos. 85-7844
85-7846

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the Order of said District Court be and it hereby is affirmed in part and reversed and remanded in part to the said district court for further proceedings in accordance with this opinion.

ELAINE B. GOLDSMITH,
Clerk

/s/ Edward J. Guardaro
Edward J. Guardaro,
Deputy Clerk

APPENDIX E

District Court Cases Addressing the Enforceability of Agreements to Arbitrate § 10(b) Claims

A. Cases Holding § 10(b) Claims Arbitrable

First Circuit

Arent v. Shearson/American Express, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,523 (D. Mass. Dec. 20, 1985)

Mowbray v. Moseley, Hallgarten, Estabrook & Weden, Inc., No. 83-2851-C (D. Mass. July 16, 1985), *vacated*, No. 85-1647 (1st Cir. July 3, 1986)

Prawer v. Dean Witter Reynolds, Inc., 626 F. Supp. 642 (D. Mass. 1985)

Sevinor v. Merrill Lynch, Pierce, Fenner & Smith, No. 84-3240-N (D. Mass. July 19, 1985) (appeal pending)

Second Circuit

Brener v. Becker Paribas Inc., 628 F. Supp. 442 (S.D.N.Y. 1985)

Finkle & Ross v. A.G. Becker Paribas, Inc., 622 F. Supp. 1505 (S.D.N.Y. 1985)

Ilan v. Shearson/American Express, Inc., 632 F. Supp. 886 (S.D.N.Y. 1985)

Intre Sport Ltd. v. Kidder Peabody & Co., 625 F. Supp. 1303 (S.D.N.Y. 1985), *modified*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,714 (S.D.N.Y. Apr. 21, 1986) (decided after *McMahon* but following *AFP Imaging Corp.*)

Jarvis v. Dean Witter Reynolds, Inc., 614 F. Supp. 1146 (D. Vt. 1985)

Johnson v. Kidder Peabody & Co., No. 85 Civ. 178 (N.D.N.Y. July 29, 1985)

McMahon v. Shearson/American Express, Inc., 618 F. Supp. 384 (S.D.N.Y. 1985), *aff'd in part, rev'd in part*, 788 F.2d 94 (2d Cir. 1986)

Shamir v. Kidder, Peabody & Co., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,511 (S.D.N.Y. Mar. 11, 1986)

Terra Resources I v. Burgin, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,703 (S.D.N.Y. Apr. 1, 1986)

Wall Street Assocs. v. Becker Paribas, Inc., No. 85 Civ. 4649 (S.D.N.Y. Sept. 19, 1985)

Third Circuit

Baker v. Paine, Webber, Jackson & Curtis, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,757 (D. N.J. Apr. 10, 1986)

Fourth Circuit

Fisher v. Prudential-Bache Securities, Inc., No. Y-86-388 (D. Md. May 12, 1986) (appeal pending)

Land v. Dean Witter Reynolds, Inc., 617 F. Supp. 52 (E.D. Va. 1985)

Shotto v. Laub, 632 F. Supp. 516 (D. Md. 1986)

Fifth Circuit

Coonly v. Rotan Mosle, Inc., No. A-83-CA-529 (W.D. Tex. June 11, 1985)

Frye v. Paine Webber Jackson & Curtis, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,516 (N.D. Tex. Dec. 26, 1985)

Hymel v. Delta Petroleum & Energy Corp., No. SA-83-CA-362 (W.D. Tex. June 19, 1985)

McKinney v. Sutton, No. C-85-15 (S.D. Tex. Nov. 8, 1985)

Russell v. Shearson Lehman Bros., Inc., No. CA3-85-2335-R (N.D. Tex. Mar. 10, 1986) (appeal pending)

Sixth Circuit

Drazdik v. Kidder, Peabody & Co., No. C-85-2442 (N. D. Ohio Mar. 31, 1986) (appeal pending)

Gerhardstein v. Shearson/American Express, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,512 (N.D. Ohio Mar. 3, 1986)

Moncrieff v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 623 F. Supp. 1005 (E.D. Mich. 1985)

Yee v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., No. 84-4017 (E.D. Mich. Mar. 31, 1986)

Seventh Circuit

Austad v. Drexel Burnham Lambert, Inc., No. 85-C-9759 (N.D. Ill. Mar. 27, 1986)

Steinberg v. The Illinois Co., No. 85-C-7131 (N.D. Ill. May 15, 1986)

Willis v. Prudential-Bache Securities, Inc., No. L 85-0059 (N.D. Ind. July 10, 1985)

Eighth Circuit

Bob Ladd, Inc. v. Adcock, 633 F. Supp. 241 (E.D. Ark. 1986)

Houlihan v. Schmacker and *Meyer v. Schmacker*, Nos. 83-159 C(5) and 83-1356 C(5) (E.D. Mo. May 3, 1985)

Peele v. Kidder, Peabody & Co. Inc., 620 F. Supp. 61 (W.D. Mo. 1985) (appeal pending)

Sulit v. Dean Witter Reynolds, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,755 (W.D. Mo. Mar. 27, 1986)

Ninth Circuit

Anderson v. Paine Webber Jackson & Curtis, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,446 (C.D. Cal. Sept. 23, 1985)

Blakley v. Prudential Bache Securities, Inc. No. R-85-442 (D. Nev. Dec. 9, 1985)

Byrd v. Dean Witter Reynolds, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,225 (S.D. Cal. July 8, 1985) (on remand from Supreme Court)

Dees v. Distenfield, 618 F. Supp. 123 (C.D. Cal. 1985)

Geller v. Nasser, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,409 (C.D. Cal. Nov. 18, 1985)

Jope v. Bear Stearns & Co., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,393 (N.D. Cal. Nov. 15, 1985)

Mann v. Foster & Marshall/American Express, Inc., No. C84-925D (W.D. Wash. June 3, 1985)

Marx v. Dean Witter Reynolds, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,311 (C.D. Cal. Aug. 23, 1985)

Sacks v. Dean Witter Reynolds, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,429 (C.D. Cal. Dec. 31, 1985)

Sapa v. Kelly, No. CV 85 1292 (S.D. Cal. Aug. 20, 1985)

West v. Drexel Burnham Lambert, Inc., 623 F. Supp. 26 (W.D. Wash. 1985)

Tenth Circuit

Butz v. Dean Witter Reynolds, Inc., No. 83-7-2043 (D. Colo. Apr. 16, 1985)

Eleventh Circuit

Ackerman v. Drexel Burnham Lambert, Inc., No. 84-6739 (S.D. Fla. May 14, 1985)

Adrian v. Smith Barney, Harris Upham & Co., No. 84-1652-Civ-T-13 (M.D. Fla. Sept. 17, 1985)

Batteh v. Prudential-Bache Securities, Inc., No. 84-452-Civ-J-14 (M.D. Fla. July 29, 1985)

Boyd v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 614 F. Supp. 940 (S.D. Fla. 1985)

Butler v. Dean Witter Reynolds, Inc., No. CV 84-L-5680-NE (N.D. Ala. Sept. 5, 1985)

Byrne v. Oppenheimer & Co., No. 84-264-Civ-T-17 (M.D. Fla. Aug. 2, 1985)

Chandler v. Drexel Burnham Lambert, Inc., No. C-85-1585-A (N.D. Ga. Oct. 29, 1985) (appeal pending)

Colangelo v. Dean Witter Reynolds, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,365 (M.D. Fla. July 23, 1985)

Crabb v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 84-1145-Civ-J-12 (M.D. Fla. Oct. 7, 1985)

Driscoll v. Smith Barney, Harris Upham & Co., No. 84-8223 (S.D. Fla. June 6, 1985)

Finn v. Davis, 610 F. Supp. 1079 (S.D. Fla. 1985)

Greenstein v. First Biscayne Corp., No. 82-0584 Civ. (S.D. Fla. May 16, 1985)

Gregory v. Merrill Lynch, Pierce, Fenner & Smith, No. 84-1647 Civ. 1-10 (M.D. Fla. Apr. 9, 1985)

Greist v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 83-6826-Civ (S.D. Fla. Aug. 26, 1985)

Hashemi v. Merrill Lynch, Pierce, Fenner & Smith, No. C82-2948A (N.D. Ga. Aug. 6, 1985)

Leffler v. Prudential-Bache Securities, Inc., No. 84-1292-Civ-J-12 (M.D. Fla. Sept. 5, 1985)

Miller v. Drexel Burnham Lambert, Inc., No. 83-6871 (S.D. Fla., July 31, 1985), *rev'd*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,783 (11th Cir. June 17, 1986) (per curiam)

Niven v. Dean Witter Reynolds, Inc., [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,059 (M.D. Fla. Mar. 28, 1985)

Oliver v. Harris, No. CV 184-93 (S.D. Ga. Aug. 29, 1985)

Pruzan v. Paine, Webber, Jackson & Curtis, No. C84-2016A (N.D. Ga. Aug. 30, 1985)

Raiford v. Merrill Lynch, Pierce, Fenner & Smith, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,269 (N.D. Ga. May 16, 1985)

Rockoff v. Shearson Lehman/American Express, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,513 (S.D. Fla. Feb. 12, 1986)

Ross v. Mathis, 624 F. Supp. 110 (N.D. Ga. 1985)

Rowles v. Dean Witter Reynolds, Inc., No. 84-1393-Civ-J-14 (M.D. Fla. Aug. 5, 1985)

Sanders v. Robinson Humphrey/American Express, Inc., [1985-86 Transfer Binder] Fed. Sec. L Rep. (CCH) ¶ 92,548 (N.D. Ga. Mar. 27, 1986)

Schultz v. Robinson-Humphrey/American Express Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,515 (M.D. Ga. Mar. 4, 1986)

Sigvartsen v. Smith Barney Harris Upham & Co., No. 84-540-Civ-T-15 (M.D. Fla. June 4, 1985)

Walch v. Dean Witter Reynolds, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,060 (M.D. Fla. Apr. 25, 1985)

Westwind Transp., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 84-734 (M.D. Fla. Apr. 9, 1985)

B. *Cases Holding § 10(b) Claims Not Arbitrable*

District of Columbia Circuit

Kalali v. Prudential-Bache Securities, Inc., No. 85-3237 (D. D.C. June 30, 1986)

Second Circuit

Becker v. Silverman, No. 85 Civ. 6757 (S.D.N.Y. June 24, 1986) (decided after *McMahon*)

Couvaris v. Paine Webber Jackson & Curtis Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,554 (S.D.N.Y. Feb. 24, 1986)

Brill v. Prudential-Bache Securities, Inc., No. 84 Civ. 0846 (S.D.N.Y. June 13, 1986) (dicta) (decided after *McMahon*)

Clark v. Kidder, Peabody & Co., Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,729 (S.D.N.Y. May 9, 1986) (decided after *McMahon*)

Farino v. Advest Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,758 (E.D.N.Y. May 1, 1986) (decided after *McMahon*)

Gilmore v. Shearson/American Express, Inc., No. 84 Civ. 9011 (S.D.N.Y. May 20, 1986) (decided after *McMahon*)

Intre Sport, Ltd. v. Kidder, Peabody & Co., [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,714 (S.D.N.Y. Apr. 21, 1986) (decided after *McMahon* but following *AFP Imaging*)

IRPA Corp. v. Shearson/American Express, Inc., No. 85 Civ. 1629 (S.D.N.Y. May 28, 1986) (decided after *McMahon*) (appeal pending)

Leone v. Advest, Inc., 624 F. Supp. 297 (S.D.N.Y. 1985)

Rush v. Oppenheimer & Co., No. 84 Civ. 3219 (S.D.N.Y. June 27, 1986) (dicta) (decided after *McMahon*)

Schlussel v. Shearson Lehman/American Express, Inc., No. 85-0835 (S.D.N.Y. Apr. 22, 1986) (decided after *McMahon*)

Suthirachartkul v. Shearson Lehman Bros., Inc., No. 85-6469 (S.D.N.Y. May 21, 1986) (decided after *McMahon*)

Weizman v. Adornato, 625 F. Supp. 1101 (E.D.N.Y. 1985)

Third Circuit

Blumenthal v. Dean Witter Reynolds, Inc., No. 84-4799F (D. N.J. July 3, 1985), *reprinted in* 2 RICO L. Rptr. 275 (1985) (appeal pending)

Erlbaum v. Prudential-Bache Securities, Inc., No. 84-5541 (E.D. Pa. Aug. 9, 1985) (appeal pending)

Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,276 (W.D. Pa. Apr. 19, 1985) (appeal pending)

Fourth Circuit

Blomquist v. Churchill, 633 F. Supp. 131 (D. S.C. 1985)

Glavin v. Prudential-Bache Securities, Inc., 623 F. Supp. 629 (D. S.C. 1985)

Levendag v. Churchill, 623 F. Supp 620 (D. S.C. 1985)

Fifth Circuit

Bustamante v. Rotan Mosle, Inc., 633 F. Supp. 303 (S.D. Tex. 1986)

King v. Drexel Burnham Lambert, Inc., No. 3-Civ-85-000-932-P (N.D. Tex. Oct. 29, 1985), *aff'd*, No. 85-1717 (5th Cir. May 28, 1986)

Seventh Circuit

Barr v. The Illinois Co., No. 84-C-2076 (N.D. Ill. Oct. 29, 1985)

Gibson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 84-C-7542 (N.D. Ill. June 18, 1985)

Goldberg v. Drexel Burnham Lambert, Inc., No. 83-C-8586 (N.D. Ill. Jan. 15, 1986)

Hughes v. Paine, Webber, Jackson & Curtis, Inc., No. 81-C-5075 (N.D. Ill. Nov. 15, 1985)

Robert A. Stone & Assocs. v. Drexel Burnham Lambert, Inc., No. 85-C-6927 (N.D. Ill. Nov. 15, 1985) (appeal pending)

Winkler v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 85-C-9120 (N.D. Ill. Apr. 25, 1986)

Eighth Circuit

Bale v. Dean Witter Reynolds, Inc. and *Haertel v. Dean Witter Reynolds, Inc.*, 627 F. Supp. 650 (D. Minn. 1986)

Nesslage v. York Securities, Inc., 107 F.R.D. 389 (E.D. Mo. 1985) (appeal pending)

Phillips v. Merrill Lynch, Pierce, Fenner & Smith, No. 4-81-394 (D. Minn. Apr. 19, 1985), *rev'd*, No. 85-5156 (8th Cir. July 9, 1986)

Webb v. R. Rowland & Co., 613 F. Supp. 1123 (E.D. Mo. 1985) (appeal pending)

Ninth Circuit

Conover v. Dean Witter Reynolds Inc., No. 83-4809 (C.D. Cal. June 12, 1985) (appeal pending)

Schnitzer v. Oppenheimer & Co., 633 F. Supp. 92 (D. Ore. 1985)

Wilcox v. Ho-Wing Sit, 586 F. Supp. 561 (N.D. Cal. 1984)

Tenth Circuit

Adams v. Merrill Lynch Pierce Fenner & Smith, Corp., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,328 (W.D. Okla. Sept. 20, 1985)

Eleventh Circuit

Gorman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 609 F. Supp. 1054 (S.D. Fla.), *aff'd*, 780 F. 2d 1032 (11th Cir. 1985) (*en banc* rehearing pending)

Krieck v. Dean Witter Reynolds, Inc., No. GCA 84-0085 (N.D. Fla. Apr. 24, 1985)

Rojas Cancanon v. Smith Barney, Harris Upham & Co., 612 F. Supp. 996 (S.D. Fla. 1985)

Sharp v. Cralin & Co., 617 F. Supp. 476 (S.D. Fla. 1985)

Wolfe v. E. F. Hutton & Co., No. 84-151-Civ-Orl-18 (M.D. Fla. Mar. 30, 1985) (consolidated with *Gorman*) (*en banc* rehearing pending)

C. *Case Stayed Pending Eighth Circuit Decision in* Phillips

Minnesota Odd Fellows Home Foundation v. Engler & Budd Co., 630 F. Supp. 797 (D. Minn. Mar. 3, 1986)

APPENDIX F

District Court Cases Addressing the Enforceability of Agreements to Arbitrate Civil RICO Claims

A. *Cases Holding Civil RICO Claims Arbitrable*

Second Circuit

Brener v. Becker Paribas Inc., 628 F. Supp. 442 (S.D.N.Y. 1985)

Dev. Bank v. Chemtex Fibers Inc., 617 F. Supp. 55 (S.D.N.Y. 1985) (international agreements to arbitrate RICO claims are enforceable)

Wall Street Assocs. v. Becker Paribas, Inc., No. 85 Civ. 4649 (S.D.N.Y. Sept. 19, 1985)

Third Circuit

Baker v. Paine, Webber, Jackson & Curtis, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,757 (D. N.J. Apr. 10, 1986)

Bright v. S & N Assocs., No. 85-6966 (E.D. Pa. June 18, 1986) (appeal pending)

Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,276 (W.D. Pa. Apr. 19, 1985) (modifying on the basis of *Byrd* the court's prior decision in the same case, reported at 605 F. Supp. 510 (W.D. Pa. 1984), that RICO claims are not arbitrable) (decided before *Mitsubishi*) (appeal pending)

Fourth Circuit

Land v. Dean Witter Reynolds, Inc., 617 F. Supp. 52 (E.D. Va. 1985)

Nunes v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. M-84-3118 (D. Md. Jan. 10, 1986)

Fifth Circuit

Russell v. Shearson Lehman Bros., Inc., No. CA3-85-2335-R (N.D. Tex. Mar. 10, 1986) (appeal pending)

Sixth Circuit

Drazdik v. Kidder Peabody & Co., No. C-85-2442 (N.D. Ohio Mar. 31, 1986) (appeal pending)

Gerhardstein v. Shearson/American Express, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,512 (N.D. Ohio Mar. 3, 1986)

Lerchen v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 83-CV-1479-DT (E.D. Mich. Nov. 29, 1985)

Yee v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 84-4017 (E.D. Mich. Mar. 31, 1986)

Seventh Circuit

Robert A. Stone & Assocs. v. Drexel Burnham Lambert, Inc., No. 85-C-6927 (N.D. Ill. Nov. 15, 1985) (appeal pending)

Steinberg v. The Illinois Co., No. 85 C 7131 (N.D. Ill. May 15, 1986)

Eighth Circuit

Bale v. Dean Witter Reynolds, Inc. and *Haertel v. Dean Witter Reynolds, Inc.*, 627 F. Supp. 650 (D. Minn. 1986)

Bob Ladd, Inc. v. Adcock, 633 F. Supp. 241 (E.D. Ark. 1986)

Ninth Circuit

Blakley v. Prudential Bache Securities, Inc., No. R-85-442 (D. Nev. Dec. 9, 1985)

Sacks v. Dean Witter Reynolds, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,429 (C.D. Cal. Dec. 31, 1985)

West v. Drexel Burnham Lambert, Inc., 623 F. Supp. 26 (W.D. Wash. 1985)

Eleventh Circuit

Adrian v. Smith Barney, Harris Upham & Co., No. 84-1652-Civ-T-13 (M.D. Fla. Sept. 17, 1985)

Colangelo v. Dean Witter Reynolds, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,365 (M.D. Fla. July 26, 1985)

Crabb v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 84-1145-Civ-J-12 (M.D. Fla. Oct. 7, 1985)

Finn v. Davis, 610 F. Supp. 1079 (S.D. Fla. 1985) (decided before *Mitsubishi*)

Greist v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 83-6826-Civ (S.D. Fla. Aug. 26, 1985)

Rockoff v. Shearson Lehman/American Express, Inc., [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,513 (S.D. Fla. Feb. 12, 1986)

Ross v. Mathis, 624 F. Supp. 110 (N.D. Ga. 1985)

B. Cases Holding Civil RICO Claims Not Arbitrable

District of Columbia Circuit

Kalali v. Prudential-Bache Securities, Inc., No. 85-3237 (D. D.C. June 30, 1986)

First Circuit

Sevinor v. Merrill Lynch, Pierce, Fenner & Smith, No. 84-3240-N (D. Mass. July 19, 1985) (appeal pending)

Second Circuit

Brill v. Prudential-Bache Securities, Inc., No. 84 Civ. 0846 (S.D.N.Y. June 13, 1986) (dicta) (decided after *McMahon*)

Farino v. Advest, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,758 (E.D.N.Y. May 1, 1986) (decided after *McMahon*)

McMahon v. Shearson/American Express Inc., 618 F. Supp. 384 (S.D.N.Y. 1985), *aff'd in part, rev'd in part*, 788 F.2d 94 (2d Cir. 1986)

S.A. Mineracao da Trindade-Samitri v. Utah Int'l Inc., 576 F. Supp. 566 (S.D.N.Y. 1983), *order certified for interlocutory appeal*, 579 F. Supp. 1049 (S.D.N.Y.), *appealed on other grounds and affirmed*, 745 F.2d 190 (2d Cir. 1984) (decided before *Mitsubishi*)

Suthirachartkul v. Shearson Lehman Bros., Inc., No. 85-6469 (S.D.N.Y. May 21, 1986) (decided after *McMahon*)

Weizman v. Adornato, 625 F. Supp. 1101 (E.D.N.Y. 1985)

Third Circuit

Blumenthal v. Dean Witter Reynolds, Inc., No. 84-4799F (D. N.J. July 3, 1985), *reprinted in* 2 RICO L. Rptr. 275 (1985)

Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 605 F. Supp. 510 (W.D. Pa. 1984) (decided before *Mitsubishi*), *modified after Byrd*, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92, 276 (W.D. Pa. April 19, 1985) (appeal pending)

Witt v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 602 F. Supp. 867 (W.D. Pa. 1985) (decided before *Mitsubishi*)

Fourth Circuit

Fisher v. Prudential-Bache Securities, Inc., No. Y-86-388 (D. Md. May 12, 1986) (appeal pending)

Universal Marine Ins. Co. v. Beacon Ins. Co., 588 F. Supp. 735 (W.D.N.C. 1984) (decided before *Mitsubishi*)

Seventh Circuit

American Concept v. Irsay, No. 84 C 0026 (N.D. Ill. Oct. 4, 1985) (appeal pending)

Myers v. Rosenberg, No. 83-C-1342 (N.D. Ill. Mar. 6, 1986)

Eighth Circuit

Webb v. R. Rowland & Co., 613 F. Supp. 1123 (E.D. Mo. 1985) (appeal pending)

Ninth Circuit

Wilcox v. Ho-Wing Sit, 586 F. Supp. 561 (N.D. Cal. 1984) (decided before *Mitsubishi*)

Eleventh Circuit

Pruzan v. Paine, Webber, Jackson & Curtis, Inc., No. C84-2016A (N.D. Ga. Aug. 30, 1985)

Roes v. Paine, Webber, Jackson & Curtis, Inc., No. C84-2311A (N.D. Ga. Mar. 29, 1985) (decided before *Mitsubishi*)

No. 86-44 (2)

Supreme Court, U.S.
FILED
AUG 13 1986
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN McNULTY,

Petitioners,

v.

EUGENE McMAHON, JULIA McMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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On the Brief

34/90

COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

1. WHETHER THE CERTIORARI JURISDICTION OF THIS COURT MAY BE PROPERLY INVOKED TO RESOLVE AN APPARENT CONFLICT, THAT HAS ONLY RECENTLY ARISEN BETWEEN THE EIGHTH CIRCUIT AND THE SECOND CIRCUIT FOLLOWING OVER THIRTY YEARS OF THIS COURT'S SETTLED LAW, AS TO WHETHER A PURCHASER OF SECURITIES MAY BE COMPELLED TO RELINQUISH FEDERAL STATUTORY RIGHTS TO JUDICIAL REVIEW AND TRIAL OF CLAIMS ASSERTED UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934, 15 U.S.C. SECTION 78a *et seq.* (the "1934 Act"), THEREBY CONTRAVENING THE CLEAR INTENT OF CONGRESS; ESTABLISHED FEDERAL POLICY; THE UNBROKEN LINE OF PRECEDENTS OF THIS COURT; AND THE JURISDICTIONAL AND ANTIWAIVER PROVISIONS OF THE 1934 ACT?

2. WHETHER CLAIMS ASSERTED UNDER THE RACKETEER INFLUENCED CORRUPT ORGANIZATIONS ACT, 18 U.S.C. SECTION 1962(c) (1982) ("RICO") MAY BE ENFORCED IN OTHER THAN A JUDICIAL FORUM IN LIGHT OF THE CLEAR INTENT OF CONGRESS AND OVERRIDING PUBLIC POLICY CONCERNS?

3. WHETHER THE SECOND CIRCUIT COURT OF APPEALS SHOULD REMAND FOR FURTHER CONSIDERATION BY THE DISTRICT COURT THE ISSUE RAISED BELOW AS TO THE VALIDITY *AB INITIO* OF PURPORTED "AGREEMENTS" TO ARBITRATE CLAIMS ASSERTED UNDER THE 1934 ACT.

RULE 28.1 LIST OF PARTIES

See Petition at ii-iii.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
RULE 28.1 LIST	ii
TABLE OF AUTHORITIES	v
STATUTORY AND REGULATORY PROVISIONS INVOLVED	x
OPINIONS BELOW	1
JURISDICTION	1
COUNTERSTATEMENT OF THE CASE	2
REASONS CERTIORARI SHOULD BE DENIED	4
I. THIS COURT SHOULD DENY CERTIORARI AS AN IMPROVIDENT EXERCISE OF ITS DISCRETIONARY REVIEW WHERE ONLY ONE OF AT LEAST EIGHT CIRCUIT COURTS OF APPEALS HAS DIVERGED FROM THE CLEAR INTENT OF CONGRESS; ESTABLISHED FEDERAL POLICY; THE UNBROKEN LINE OF PRECEDENTS OF THIS COURT; AND THE FEDERAL STATUTORY RIGHTS AFFORDED CUSTOMERS UNDER THE 1934 ACT	6
A. Notwithstanding the Recent Apparent Conflict in the Circuits that Has Arisen Solely by Virtue of a Decision in the Eighth Circuit Court of Appeals, This Court Should Decline Review of Its Own Settled Law	6

Page

B. The Second Circuit's Decision in This Case Correctly Adhered to the Well-Established Exception to the Arbitration Act for Claims Under Secton 10(b) of the 1934 Act 11

1. This Court's Recent Decisions and Second Circuit Precedent Support the Applicability to This Case of *Wilko v. Swan* Precluding Arbitration of Respondents' 1934 Act Claims 11

2. The Second Circuit's Decision Correctly Analyzed Congressional Intent in Furthering the Remedial Purpose of the 1934 Act 13

II. THE SECOND CIRCUIT CORRECTLY HELD THAT RICO CLAIMS MAY NOT BE COMPELLED TO BE ARBITRATED BECAUSE OF CONGRESSIONAL INTENT, THE VIEWS OF THIS COURT AND PUBLIC POLICY CONSIDERATIONS..... 16

A. Congress Intended to Create An Exception to the Arbitration Act for Civil RICO Claims 16

B. Public Policy Concerns Inherent in RICO Actions Preclude Arbitration 17

III. RESPONDENTS' CLAIMS ARE NOT SUBJECT TO ARBITRATION SINCE THE ARBITRATION PROVISION OF THEIR PURPORTED "AGREEMENT" IS INAPPLICABLE AND THE PARTIES DID NOT INTEND THE PETITIONERS' MISCONDUCT TO BE SUBJECT TO ANY ARBITRATION PROVISION, WHICH IN THIS CASE WAS ALLEGEDLY PROCURED BY FRAUD 20

TABLE OF AUTHORITIES

Cases	Page
AFP Imaging Corp. v. Ross, 780 F.2d 202 (2d Cir. 1985), *cert. denied* (United States June 30, 1986	12
Allegaert v. Perot, 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977)	12
Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974)	18
American Concept v. Irsay, No. 84 C 10026 (N.D. Ill. Oct. 4, 1985) (appeal pending)	17
American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821(2d Cir. 1968)	9,13,17
Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532 (3rd Cir.), *cert. denied*, 429 U.S. 1010 (1976)	7
Barrentine v. Arkansas-Best Freight System, Inc., 450 U.S. 728 (1981)	18
Bateman Eichler v. Berner, ____ U.S. ____, 105 S. Ct. 2622 (1985)	8,13
Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)	13
Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 81 L. Ed.2d 694 (1984)	21
Colonial Realty Corp. v. Bache & Co., 358 F.2d 178 (2d Cir.), *cert. denied*, 385 U.S. 817 (1966)	12
Conover v. Dean Witter Reynolds, Inc., [Current] Fed. Sec. L. Rep. (CCH) Par. 92,831 (9th Cir. July 17, 1986)	4,14,15
Dean Witter Reynolds, Inc. v. Byrd, ____ U.S. ____, 105 S. Ct. 1238 (1985)	passim

	Page
De Lancie v. Birr, Wilson & Co., 648 F.2d 1255 (9th Cir. 1981)	6
Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976)	13
Greater Continental Corp. v. Schechter, 422 F.2d 1100 (2d Cir. 1970)	12
Herman & MacLean v. Huddleston, 459 U.S. 375 (1983)	8,9,12,14, 15
Ingbar v. Drexel Burnham Lambert, Inc., 683 F.2d 603 (1st Cir. 1982)	7
Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 605 F. Supp. 510 (W.D. Pa. 1984)	17
King v. Drexel Burnham Lambert, Inc., No. 85-1717 (5th Cir. 1986)	4
Kulukundis Shipping Co., S/A v. Amtorg Trading Corp., 126 F.2d 978 (2d Cir. 1942)	9
Land v. Dean Witter Reynolds, Inc., 617 F. Supp. 52 (E.D. Va. 1985)	7
Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017 (6th Cir. 1979)	6
McDonald v. City of West Branch, ___ U.S. ___, 104 S. Ct. 1799 (1984)	18
McMahon v. Shearson/American Express, Inc., 618 F. Supp. 384 (S.D.N.Y. 1985), *aff'd in part, rev'd in part*, 788 F.2d 94 (2d Cir. 1986)	passim
McMahon v. Shearson/American Express, Inc., 788 F.2d 94 (2d Cir. 1986)	passim

	Page
Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353 (1982)	15
Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore, 590 F.2d 823 (10th Cir. 1978)	6,7
Miller v. Drexel Burnham Lambert, Inc., [Current] Fed. Sec. L. Rep. (CCH) Par. 92,783 (11th Cir. June 17, 1986)(*per curiam*)	4,6,8,22
Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., ___ U.S. ___, 105 S. Ct. 3346 (1985)	8,10,13, 17,20
Phillips v. Merrill Lynch, Pierce,Fenner & Smith, Inc., [Current] Fed. Sec. L. Rep. (CCH) Par. 92,815 (8th Cir. July 9, 1986)	passim
Prima Paint Corp. v. Flood & Conklin Manufacturing Co., 388 U.S. 395 (1967)	22
Randall v. Loftsgaarden [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,801 (July 2, 1986)	14
S.A. Mineracao da Trindade-Samitri v. Utah Int'l Inc., 576 F. Supp. 566 (S.D.N.Y. 1983), *order certified for interlocutory appeal*, 579 F. Supp. 1049 (S.D.N.Y.), *appealed on other grounds and affirmed*, 745 F.2d 190 (2d Cir. 1984)	16,17
Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974)	7,8,9,10
Sedima, S.P.R.L. v. Imrex Co., ___ U.S. ___, 105 S. Ct. 3275 (1985)	16,18,19
Sevignor v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 84-3240-N (D. Mass. July 19, 1985)	17
Sibley v. Tandy Corp., 543 F.2d 540(5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977)	7

	Page
Singer v. Dean Witter Reynolds, Inc., 614 F. Supp. 1141 (D. Mass. 1985)	7
South East Atl. Shipping Ltd. v. Garnac Grain Co., 356 F.2d 189 (2d Cir. 1966)	9
Southland Corp. v. Keating, 465 U.S. 1 (1984)	20
The Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972)	20
Touche Ross & Co. v. Reddington, 442 U.S. 560 (1979)	13,14
Universal Marine Ins. Co. v. Beacon Ins. Co., 588 F. Supp. 735 (W.D.N.C. 1984)	17
Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831 (7th Cir. 1977)	7
Wilko v. Swan, 346 U.S. 427 (1953)	passim
Witt v. Merrill Lynch, Pierce Fenner & Smith, Inc., 602 F. Supp. 867(W.D. Pa. 1985)	17
Statutes and Regulations	
Sherman Act, 15 U.S.C. Section 1, *et seq.*	16,17
Securities Act of 1933, 15 U.S.C. Section 77a, *et seq.*	passim
Section 12(2), 15 U.S.C. Section 771 (2)	passim
Section 14, 15 U.S.C. Section 77n	13
Securities Exchange Act of 1934, 15 U.S.C. Section 78a, *et seq.*	passim
Section 10(b), 15 U.S.C. Section 78j(b)	passim
Section 19, 15 U.S.C. Section 78s	22
Section 27, 15 U.S.C. Section 78aa	13
Section 29(a), 15 U.S.C. Section 78cc(a)	13

Page

Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. Section 1961, *et seq.* ..... passim

United States Arbitration Act, 9 U.S.C. Section 1, *et seq.* ..... passim

Rules and Regulations

Securities and Exchange Commission Rule 10b-5 (17 C.F.R. Section 240.10b-5) ..... passim

Securities and Exchange Commission Rule 15c2-2 (17 C.F.R. Section 240.15c2-2) 21

Treatises

13 Moore's Federal Practice, SC17-1 *et seq.*, Par. 817.01 *et seq.* (1985) 6

Other Materials

SEC Securities Exchange Act Release No. 15984 (July 2, 1979), 17 SEC Docket 1167 (1979) 21

SEC Securities Exchange Act Release No. 20397 (November 28, 1983), 48 Fed. Reg. 53404 (1983) 21

STATUTORY AND REGLATORY PROVISIONS INVOLVED

United States Arbitration Act

Sections 2-4, 9 U.S.C. Sections 2-4

Securities Act of 1933 (the "1933 Act")

Section 12(2), 15 U.S.C. Section 771(2)
Section 14, 15 U.S.C. Section 77n

Securities Exchange Act of 1934 (the "1934 Act")

Section 10(b), 15 U.S.C. Section 78j(b)
Section 19, 15 U.S.C. Section 78(s)
Section 27, 15 U.S.C. Section 78aa
Section 29(a), 15 U.S.C. Section 78cc(a)

Racketeer Influenced and Corrupt Organizations Act ("RICO")

Section 1962, 18 U.S.C. Section 1962
Section 1964(c), 18 U.S.C. Section 1964(c)

Securities and Exchange Commission Regulations

Rule 10b-5, 17 C.F.R. Section 240.10b-5
Rule 15c2-2, 17 C.F.R. Section 240.15c2-2

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* The text of these provisions is reproduced in full at Appendix A annexed to Petition, with the exception of 15 U.S.C. Section 78aa, discussed *infra*.

No. 86-44

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN McNULTY,

Petitioners,

v.

EUGENE McMAHON, JULIA McMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

See Petition for Writ of Certiorari of Petitioners (hereinafter the "Petition") at 2, and A-6 to A-29 thereto.

JURISDICTION

See Petition at 2.

COUNTERSTATEMENT OF THE CASE

This is an action brought by Eugene McMahon and Julia McMahon individually and on behalf of various trusts (collectively "respondents") against Shearson/American Express, Inc. the predecessor of petitioner Shearson Lehman Brothers Inc. ("Shearson"), a brokerage firm registered with the Securities and Exchange Commission and against Mary Ann McNulty ("McNulty") (collectively "petitioners"), a registered representative, employee and vice president of Shearson, who was responsible for respondents' accounts during the time period referred to in the amended complaint. The amended complaint alleges in essence that petitioner McNulty, with the knowledge and consent of petitioner Shearson, engaged in the fraudulent and wilful churning, or practice of trading excessively solely to maximize commissions, not only of respondents' individual accounts, but also of the accounts for the trusts; intentionally and recklessly violated Section 10(b) of the Securities and Exchange Act of 1934, the 1934 Act, and Rule 10b-5 promulgated thereunder, by making false statements and omitting material facts in the advice given respondents and by fraudulently dissipating the funds of respondent Julia McMahon and those of numerous other investors representing the general public in a scheme known as the Golden Apple Hedge Fund; and violated the provisions of the RICO statute, 18 U.S.C. Section 1961, *et seq*. The amended complaint also alleges pendent common law claims of fraud, misrepresentation and breach of fiduciary duty.

Specifically, the amended complaint alleges as a first count multiple acts of fraudulent, inappropriate and excessive trading on the part of petitioners in connection with the joint account of the individual respondents, in which, for example, over 400 options were allegedly traded with commissions totalling approximately $50,000. As stated above, these options trades were not in accordance with respondents' stated conservative investment objectives and were not suited to secure their retirement objectives.

The second count of the amended complaint alleges claims of securities fraud by petitioners in relation to the four trust

accounts, where over 3,500 option trades are alleged in which petitioners reaped over $150,000 in commissions. Thus, on a quantitative level, the great majority of trading was performed in the trust accounts. Overall, over $200,000 in excessive commissions were allegedly earned by petitioners for these option trades.

The volatility of the options market was allegedly hidden from respondents, who were not given the information they requested regarding their accounts with petitioners nor were respondents in any way sophisticated in the securities field, having no college degrees nor financial industry acumen and no prior investment experience in anything more risky than municipal bonds, treasury bills and money market accounts.

The representations made by petitioners to respondents as asserted in the amended complaint, of a guarantee of appreciation through conservative investment policies, did not come to fruition. Indeed, it is alleged that the practices of petitioners caused the opposite result of steep losses.

The third count of the amended complaint alleges a scheme by petitioners to defraud respondent Julia McMahon and to utilize her good name in recruiting third parties to similarly invest in the Hedge Fund, where trading of options also occurred. The RICO count is pleaded on behalf of all respondents.

The course of the proceedings began when respondents filed their complaint on or about May 11, 1984. Petitioners vigorously contested this matter for almost one year before bringing on their motion to compel arbitration which was the subject of the appeal below. On July 13, 1984, petitioners filed a notice of motion to dismiss the complaint. Petitioners also filed their notice to take the depositions of the individual respondents. Following the filing of an amended complaint by stipulation, petitioners filed yet another motion to dismiss the amended complaint on January 14, 1985. During the pendency of petitioners' second motion to dismiss, petitioners moved to compel arbitration of respondents' claims on April 15, 1985,[1] almost one year after the

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[1] Not coincidentally, petitioners' motion to compel was filed shortly after this Court decided *Dean Witter Reynolds Inc. v. Byrd*, ____ U.S ____, 105 S. Ct. 1238 (March 4, 1985).

original complaint had been filed, and after petitioners had vigorously defended the lawsuit in the judicial forum during the lengthy period following the service of the original complaint.

The district court, per the Honorable Lloyd F. MacMahon, *declined* to dismiss any of respondents' claims, but nevertheless ordered arbitration of all respondents' claims except their RICO claims, temporarily stayed the RICO claims pending arbitration and placed the action on the district court's suspense docket pending the outcome of arbitration.

Respondents appealed to the United States Court of Appeals for the Second Circuit. Petitioners cross-appealed the district court's denial of their motion to arbitrate respondents' RICO claims.

On April 16, 1986, the Second Circuit affirmed in part and reversed and remanded in part, holding that the district court should not have departed from the Second Circuit's precedent in granting petitioners' motion to compel arbitration of 1934 Act claims. The Second Circuit affirmed the district court's denial of petitioners' motion to compel arbitration of the RICO claims and the lower court's direction as to arbitration of respondents' state law claims.

CERTIORARI SHOULD BE DENIED

The Second Circuit and every other Circuit Court but one that has decided the issue, either before or after this Court's decision in *Dean, Witter, Reynolds, Inc. v. Byrd, supra*, ____ U.S. ____, 105 S. Ct. 1238,[2] have adhered to the long-settled rule, established

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[2] Since *Byrd*, decisions have been rendered by the Fifth, Ninth and Eleventh Circuits in accord with the Second Circuit's decision in *McMahon*, barring arbitration of Section 10(b) claims. *See King v. Drexel Burnham Lambert, Inc.*, No. 85-1717 (5th Cir. May 28, 1986); *Miller v. Drexel Burnham Lambert, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) Par. 92,783 (11th Cir. June 17, 1986) (*per curiam*); *Conover v. Dean Witter Reynolds, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) Par. 92,831 (9th Cir. July 17, 1986), citing *McMahon v. Shearson/American Express*, 788 F.2d 94 (2d Cir. 1986). Petitioners have stated that currently *Miller* is under reconsideration *en banc* by the Eleventh Circuit (Petition at 15, n.7). Respondents currently are aware of arguments that have been held in cases that are *sub judice* in the Third and Fourth Circuits.

by Congress, federal policy and case law following this Court's decision in *Wilko v. Swan*, 346 U.S. 427 (1953), that pre-dispute arbitration agreements are unenforceable with respect to claims under Section 10(b) of the 1934 Act.

The lone, anomalous exception to this rule is the recent decision of the Eighth Circuit Court of Appeals in *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶92,815 (8th Cir. July 9, 1986), which, despite the precedents established by the other Circuits and this Court, enforced an agreement to arbitrate Section 10(b) claims.

The Court should deny certiorari because:

1. It would be improvident of the Court to exercise its discretionary review where only one of at least eight Circuit Courts of Appeals has diverged from the clear intent of Congress; established federal policy; the unbroken line of precedents of this Court; and the federal statutory rights afforded customers under the 1934 Act.

2. The Second Circuit's decision in this case correctly adhered to the well-settled exception to the Arbitration Act for claims under Section 10(b) of the 1934 Act, and the exception to the Arbitration Act for claims under RICO.

3. The decision below was so obviously correct as to warrant no further review.

I. This Court Should Deny Certiorari as an Improvident Exercise of Its Discretionary Review Where Only One of At Least Eight Circuit Courts of Appeals Has Diverged from the Clear Intent of Congress; Established Federal Policy; the Unbroken Line of Precedents In This Court; and the Federal Statutory Rights Afforded Customers Under the 1934 Act

A. Notwithstanding the Recent Apparent Conflict in the Circuits that Has Arisen Solely by Virtue of a Decision in the Eighth Circuit Court of Appeals, This Court Should Decline a Review of Its Own Settled Law

The thrust of petitioners' argument that review of this case is appropriate at this time is that the Eighth Circuit in *Phillips* disagreed with the Second Circuit's decision in this case, thereby creating a conflict within the Circuits.

However, the established rule in this Court is that a review on writ of certiorari rests firmly with the discretionary power of the Court, is not a matter of right and may, but need not, be granted when it arises by virtue of a decision by a federal Court of Appeals in conflict with the decision of another federal Court of Appeals on the same matter. *See* Supreme Court *Rule* 17(a); 13 Moore's Federal Practice, at SC 17-1 *et seq.*, Par. 817.01 *et seq.* (1985).

One need only look to the numerous Circuit Court decisions holding contrary to the Eighth Circuit's holding in *Phillips*, and conceded by the *Phillips* court in its opinion[3] (*Phillips, supra,*

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[3] *Contra Phillips*: *Miller v. Drexel Burnham, Inc., supra,* (11th Cir. June 17, 1986); *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94, 98 (2d Cir. 1986); *De Lancie v. Birr, Wilson & Co.*, 648 F.2d 1255, 1258-59 (9th Cir. 1981); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1030 (6th Cir. 1979); *Merrill*

(footnote continued)

[Current] Fed. Sec. L. Rep. (CCH) ¶92,815 at 93,989), to recognize that the *Phillips* decision is anomalous and neither represents the position of eight other Circuits on this issue nor the precedent of this Court. The apparent conflict created by *Phillips* is neither substantial nor important enough to warrant this Court's plenary review.

That *Phillips* is anomalous in the face of thirty-odd years of settled law following *Wilko* is illuminated by the dissent of the Honorable Circuit Judge Ross, a member of the Eighth Circuit panel, who objected strenuously from the *Phillips* decision, and stated the case herein succinctly:

> "I cannot agree with the majority's holding that predispute arbitration agreements are enforceable with regard to claims arising under section 10(b) of the 1934 Act and Rule 10b-5. I adhere to the position that *Wilko v. Swan*, 346 U.S. 427 (1953) applies and therefore precludes arbitration of such federal securities claims.
>
> I take this position for three reasons. First, *Wilko* is still good law, and as the majority points out, eight circuits have exended it to 1934 Act claims. *See ante* p. 6. Moreover, neither *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974) nor *Dean Witter Reynolds, Inc. v. Byrd*,

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Lynch, Pierce, Fenner & Smith, Inc. v. Moore, 590 F.2d 823, 827-29 (10th Cir. 1978); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831, 833-35 (7th Cir. 1977); *Sibley v. Tandy Corp.*, 543 F.2d 540, 543 n.3 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977); *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536 (3rd Cir.), *cert. denied*, 429 U.S. 1010 (1976).

The Fourth, First and D.C. Circuits do not appear to have ruled *per se* on this question to date. *See Land v. Dean Witter Reynolds, Inc.*, 617 F. Supp. 52 (E.D. Va. 1985); *Singer v. Dean Witter Reynolds, Inc.*, 614 F. Supp 1141 (D. Mass. 1985); *cf. Ingbar v. Drexel Burnham Lambert, Inc.*, 683 F.2d 603, n.1 (1st Cir. 1982) (recognized nonetheless that *Wilko* has been extended overwhelmingly by case law to 1934 Act claims).

Respondents respectfully submit that the proper course is to await the views of the Circuit Courts where decisions are pending before certiorari is granted on these issues.

> 105 S. Ct. 1238 (1985) hold that *Wilko* would not apply in the context of a section 10(b) or Rule 10b-5 claim. Second, in my judgment the similarity of the nonwaiver provisions of the 1933 Act and the 1934 Act is of critical importance because I view section 14 of the 1933 Act to be the lynchpin of the *Wilko* analysis. Third, the policy considerations which underlay *Wilko*, *see* 346 U.S. at 435-37, apply to the 1934 Act claims as well.
>
> Because of the absence of clear precedent in this circuit, I would give deference to the decisions of the Second Circuit in *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94, 98 (2d Cir. 1986) and the Eleventh Circuit in *Miller v. Drexel Burnham, Inc.*, No. 85-5692 (11th Cir. June 17, 1986) (per curiam)...and hold that claims under section 10(b) and Rule 10b-5 are not arbitrable. Accordingly, in the instant case I would affirm the order of the district court denying the motion to compel arbitration of the claims arising under the 1934 Act."

Phillips, *supra*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,815 at 93,992 (citation omitted).

The Second Circuit's opinion below, and *not Phillips*, is clearly consistent with the long line of precedents in this Court beginning with *Wilko v. Swan*, *supra*, and followed by *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974); *Herman and MacLean v. Huddleston*, 459 U.S. 375 (1983); *Dean Witter Reynolds, Inc. v. Byrd*, *supra*; *Bateman Eichler v. Berner*, ____ U.S. ____, 105 S. Ct. 2622 (1985); and *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, ____ U.S. ____, 105 S. Ct. 3346 (1985).

It is significant, therefore, that the Petition (at 7-9) relegates the numerous progeny in the Circuits of this Court's holding in *Wilko v. Swan* to mere footnote status. The Petition belabors the erroneous and misleading presumption that the *McMahon* decision somehow reflects a judicial distrust of arbitration by the Second Circuit. Nothing could be farther from the truth, since the Second Circuit has stated on many occasions that its decisions

and policy "reflect exactly the contrary point of view." *American Safety Equipment Corp. v. J.P. Maguire & Co.*, 391 F.2d 821, 827 (2d Cir. 1968), citing *South East Atl. Shipping Ltd. v. Garnac Grain Co.*, 356 F.2d 189, 192-193 (2d Cir. 1966); *Kulukundis Shipping Co., S/A v. Amtorg Trading Corp.*, 126 F.2d 978, 985 (2d Cir. 1942).

Needless to say, the Petition fails utterly to disclose the public policy rationale underlying the Second Circuit's decision in this case, as will be discussed below, and the remedial purpose intended by Congress in enacting the securities laws and in amending them in 1975. Instead, petitioners attempt to draw the Court's attention away from the policy rationale extending *Wilko* to the 1934 Act by drawing artificial distinctions between the 1933 Act and the 1934 Act, thereby attempting to limit the applicability of *Wilko* to Section 10(b) claims.

As this Court recognized in *Herman and MacLean v. Huddleston*, *supra*, 459 U.S. at 384-389, the rights afforded under the 1933 and 1934 Acts are cumulative and are in support of their remedial purpose, and "[t]he effectiveness of the broad proscription against fraud in Section 10(b) would be undermined if its scope were restricted by the existence of an express remedy under Section 11. *Id.*, 459 U.S. at 386 (citations omitted). Under this Court's holding in *Herman & MacLean v. Huddleston*, any interpretation of the securities laws that would have the effect of displacing an action under Section 10(b) was *explicitly rejected*. *Id.*, 459 U.S. at 387. Thus, it is respectfully submitted that this Court should discourage clearly any attempt to undermine the so-called "implied" but judicially and congressionally recognized right of action under the 1934 Act simply because there exists an "express" remedy under the 1933 Act.

The policy considerations which gave vitality to *Wilko* and the case law that followed its teachings is documented in the cogent dissent in *Scherk v. Albert-Culver Co.*, *supra*, which was joined by Justice White:*

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* Whether or not intended, *dicta* in Justice White's subsequent concurring opinion in *Byrd* has somehow formed the basis for some judicial interpretation

(footnote continued)

> "We spoke at length in *Wilko* of this problem, elucidating the underdesirable effects of remitting a securities plaintiff to an arbitral, rather than a judicial, forum. Here, as in Wilko, the allegations of fraudulent misrepresentation will involve 'subjective findings on the purpose and knowledge' of the defendants, questions ill-determined by arbitrators without judicial instruction on the law. See [*Wilko*, 346 U.S.] at 435. An arbitral award can be made without explication of reasons and without development of a record, so that the arbitrator's conception of our statutory requirements may be absolutely incorrect but functionally unreviewable, even when the arbitrator seeks to apply our law. We recognized in *Wilko* that there is no judicial review corresponding to review of court decisions. *Id.* at 436-437. The extensive pretrial discovery provided by the Federal Rules of Civil Procedure for actions in district court would not be available. And the wide choice of venue provided by the 1934 Act, ..., would be forfeited. See *Wilko v. Swan*, *supra*, at 431, 435. *The loss of the proper judicial forum carries with it the loss of substantial rights.*"

Scherk v. Alberto-Culver Co., *supra*, 417 U.S. at 532 (citation omitted, emphasis added).

Neither *Scherk* nor *Mitsubishi*, *supra*, which were decided in the context of international disputes, nor the *Byrd* decisions of this Court altered the applicability of *Wilko* in the context of Section 10(b) or Rule 10(b)-5 claims. Indeed, the rationale of *Wilko v. Swan* was approvingly recognized by this Court in *Byrd* to have "retained considerable vitality in the lower federal courts" with respect to claims arising under Section 10(b) of the 1934 Act; the Court acknowledged that "agreements to arbitrate [1934 Act] claims are therefore unenforceable." *Byrd*, *supra*, at 1240,

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contra the extension of the *Wilko* doctrine to 1934 Act claims. Many courts, however, have continued to adhere to the *Wilko* rule. *See* Petition at Appendix E, subparagraph B, at A-38 to A-42.

n.1. Also in *Byrd*, this Court, albeit in another context, conceded that "arbitration cannot provide an adequate substitute for a judicial proceeding" in protecting certain federal statutory rights that are statutorily safeguarded. *Id.*, at 1243.

Thus, the citation in the Petition (at 9, n.5) of the rules that obtain in the various stock exchange arbitration proceedings and generally under the N.A.S.D. Uniform Code of Arbitration is misplaced. There is simply no evidence to demonstrate that the defrauded investor would be in any way adequately protected as to his or her substantive rights under the securities laws without the protection and safeguards available only in litigation, as outlined in *Wilko*. Since the "substantial rights" inherent in litigation are generally unavailable in arbitrations of securities law claims, federal court litigation of Section 10(b) claims and arbitration of pendent state law claims, the "bifurcated" proceedings mandated by *Byrd*, cannot fairly be construed as duplicative either substantively or procedurally. (*contra* Petition at 17, n.12).

The Court should, therefore, deny the Petition and decline to review the settled law on this issue, thereby affirming the Second Circuit's application of *Wilko* barring arbitration of respondents' 1934 Act claims.

B. The Second Circuit's Decision in This Case Correctly Adhered to the Well-Established Exception to the Arbitration Act for Claims under Section 10(b) of the 1934 Act

1. This Court's Recent Decisions and Second Circuit Precedent Support the Applicability to This Case of *Wilko v. Swan* Precluding Arbitration of Respondents' 1934 Act Claims

As stated above, the Eighth Circuit's decision in the *Phillips* case is anomalous for its failure to defer to the overriding precedents in the other Circuits precluding arbitration of federal securities claims under Section 10(b). The Second Circuit, by relying on its own precedent, correctly followed the exception to the Arbitration Act carved out by *Wilko*:

> "As our late colleague, Judge Friendly, noted in *Colonial Realty v. Bache & Co.*, 358 F.2d 178, 183 n.5 (2

> Cir.), *cert. denied*, 385 U.S. 817 (1966), the non-waiver provision of Section 14 of the 1933 Act has an almost identical counterpart in Section 29(a) of the 1934 Act. In view of *Wilko* and the similarity of the non-waiver provisions of the 1933 and 1934 Acts, we consistently have held that Section 10(b) and Rule 10b-5 claims are not arbitrable. In *Greater Continental Corp. v. Schechter*, 422 F.2d 1100, 1103 (2 Cir. 1970), we observed that alleged violations of Rule 10b-5 were 'properly litigated in the courts where a complete record is kept of the proceedings and findings and conclusions are made.' We also pointed out the similarity between Section 14 of the 1933 Act and Section 29(a) of the 1934 Act. *Id.* In *Allegaert v. Perot*, 548 F.2d 432, 436-38 (2 Cir.), *cert. denied*, 432 U.S. 910 (1977), we reiterated the view that claims under Section 10(b) of the 1934 Act are not arbitrable, noting that the broad policy questions involved in securities law claims require a judicial forum for resolution of disputes. Again in *AFP Imaging Corp. v. Ross*, 780 F.2d 202, 205 (2 Cir. 1985), [*cert. denied*, June 30, 1986] we held that, in an action which alleged violations of Section 10(b) and Rule 10b-5, an arbitration clause in the contract was 'unenforceable under the law of this Circuit.' "

McMahon, *supra*, 788 F.2d at 96-97.

The Second Circuit in the *McMahon* decision correctly followed the holdings of this Court by recognizing that the distinctions between the 1934 Act and the 1933 Act are, in practical terms, distinctions without real differences. Thus, this Court has determined and recognized that the provisions of the Act are not coextensive with common law doctrines of fraud, *Herman & MacLean v. Huddleston*, *supra*, 459 U.S. at 388-89, and that "a private right of action under Section 10(b) of the 1934 Act and Rule 10b-5 has been consistently recognized for more than 35 years. *The existence of this implied remedy is simply beyond peradventure.*" *Id.*, at 380 (citations omitted, emphasis added) citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). *See also Bateman Eichler v. Berner*, *supra*, ____ U.S. ____, 105 S. Ct. at

2628 (the court rejected the argument that an implied remedy under Section 10(b) stood on any different footing from an express federal statutory remedy, citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975)). The Second Circuit also recognized, just as Justice White did in *Byrd*, that the non-waiver provision of Section 14 of the 1933 Act and its counterpart in Section 29(a) of the 1934 Act are almost identical.

Nothing in any of the recent holdings of this Court can be fairly interpreted as in conflict with the well-reasoned decision of the Second Circuit in *McMahon*. Indeed, in *Mitsubishi*, *supra*, this Court, noting the international nature of the contract and dispute there, nonetheless acknowledged an exception to arbitration in regard to claims in a domestic dispute. 105 S. Ct. at 3355, citing *American Safety Equipment Corp. v. J.P. Maguire & Co.*, *supra*, 391 F.2d 821.

2. The Second Circuit's Decision Correctly Analyzed Congressional Intent in Furthering the Remedial Purpose of the 1934 Act

A fortiori, it is clearly evident from the legislative history of the securities laws and their scope that Congress intended to create the right of action to enforce the duties arising under Section 10(b) of the 1934 Act. The right to a judicial forum is a right that cannot be waived under Section 29(a) of the 1934 Act, since Section 27 of the 1934 Act expressly grants jurisdiction to federal district courts over violations of the Act and suits to enforce any liability or duty thereunder and provides for venue and service of process. It creates no cause of action of its own force and effect and imposes no liabilities.[5] *Touche Ross v. Reddington*, 442

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[5] Section 27, as set forth in 15 U.S.C. Section 78aa, provides, in pertinent part, as follows: "The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States *shall* have exclusive jurisdiction of violations of this chapter or the *rules* and *regulations* thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the *rules* and *regulations* thereunder." (emphasis added). Respondents submit that Congress thus *intended* that the *right* to a judicial *federal* court forum given under Section 27 is unwaivable and may not be forfeited by virtue of Section 29(a) of the 1934 Act.

U.S. 560, 99 S. Ct. 2479, 2481 (1979). Finally, the right of action under Section 10(b) carries with it the requirement that the plaintiff must prove that the defendant acted with "scienter," thus imposing a heavier burden of proof that is least likely to be accomplished in an arbitration proceeding, where discovery is essentially voluntary and not subject to the protections of the Federal Rules of Civil Procedure.

The remedial purpose of the 1934 act is well-documented. Just last term, Justice O'Connor, who delivered the opinion of the Court in *Randall v. Loftsgaarden*, held that:

> "Congress' aim in enacting the 1934 Act was not confined solely to compensating defrauded investors. Congress intended to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions. *Affiliated Ute Citizens, supra*, at 151; see also *Hermann & McLean*, 459 U.S., at 386-387."

Randall v. Loftsgaarden, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,801 at 93,920 (July 2, 1986).

No amount of equivocation by petitioners, urging the subjugation of the 1934 Act to the broker-dealers' well-known predilection for a non-judicial forum to air claims against them, alters this legislative history. As the Ninth Circuit held just recently in *Conover v. Dean Witter Reynolds, Inc.*, *supra*, the unbroken line of precedent in this Court and the Circuits upholding the *judicial* forum for 1934 Act claims was left undisturbed by Congress in its 1975 examination of the securities laws:

> "The legislative and judicial history tells us, [first, that the implied cause of action in federal court...has become well-established, and its nonwaivable character has become well accepted by the SEC, the courts and Congress] second, that Congress could have eliminated the federal cause of action for section 10(b) in 1975, when it undertook comprehensive revision of the 1933 and 1934 Act, had it chosen to do so. Congress' revision, however, left section 10(b) intact.

> "The history tells us, third, and most important, that in 1975, Congress expressly recognized the non-arbitrable nature of disputes between brokers and customers. In the conference report to the Securities Act Amendment of 1975, Congress emphasized that its amendment to section 28 of the Securities Exchange Act of 1934, which permitted arbitration agreements between brokers and exchanges, did not extend to arbitration agreements between brokers and customers:
>
> > 'It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan*, 346 U.S. 427 (1953), concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.'
>
> H.R. Rep. No. 229, 94th Cong., 1st Sess. 111, *reprinted in* 1975 U.S. Code Cong. & Ad. News 321, 342."

Conover v. Dean Witter Reynolds, Inc., *supra*, [Current] Fed. Sec. L. Rep., par. 92,831 at 94,042. *See also Hermann & McLean v. Huddleston*, *supra*; *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 379 (1982) (finding comprehensive amendments to Commodities Act evidence that Congress intended preservation of implied remedy under the Act).

Clearly then, when all factors are considered — the purpose, the legislative history and the focus and language of the statute itself — the exception to the Arbitration Act for claims under Section 10(b) of the 1934 Act must be upheld. This result is mandated by over 30 years of this Court's settled law, the clear intent of Congress, established federal policy and the federal statutory rights afforded customers under the 1934 Act. For all the above reasons, the decision of the Second Circuit in *McMahon* should be affirmed, and the Petition should be denied.

II. The Second Circuit Correctly Held That RICO Claims May Not Be Compelled To Be Arbitrated Because of Congressional Intent, the Views of This Court and Public Policy Considerations

A. Congress Intended to Create an Exception to the Arbitration Act for Civil RICO Claims

The grant by Congress of federal court jurisdiction of RICO claims is expressly provided in 18 U.S.C. Section 1964(c):

> "Any person injured in his business or property by reason of a violation of Section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the costs of the suit, including a reasonable attorney's fee."

Thus Congress incorporated into the RICO statute the almost identical jurisdictional provision of the analogous federal antitrust laws, embodied in 15 U.S.C. Section 15. The antitrust analogy has and continues to form the basis for encouraging private enforcement of RICO claims. *See* Petition, citations at 21, n.17; *Sedima, S.P.R.L. v. Imrex Co.*, ____ U.S. ____, 105 S. Ct. 3275, 3282 (1985).

Following the enactment of the RICO statute, numerous district courts within nine Circuits[6] have held the arbitration of RICO claims to be unsuitable and indeed entirely improper because of public policy concerns that cannot be adequately protected by the arbitration procedure. Thus, the majority of courts have recognized fully that the rationale behind Congress' intent in precluding the arbitration of RICO claims has its genesis in the policy reasons underlying prohibition of arbitration of domestic antitrust claims. *See S.A. Mineracao da Trinidad-Samitri v. Utah International Inc.*, 576 F. Supp. 566 (S.D.N.Y.

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[6] *See* Petition at Appendix "F", subparagraph B, A-46 to A-48, conceding the federal judiciary's widespread adherence to the nonarbitrability of RICO claims.

1983), *ordered certified for interlocutory appeal*, 579 F. Supp. 1049 (S.D.N.Y.), *appealed on other grounds and affirmed*, 745 F.2d 190 (2d Cir. 1984). *Accord, American Concept v. Irsay*, No. 84 C 10026 (N.D. Ill. October 4, 1985); *Sevignor v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 84-3240-N (D. Mass. July 19, 1985); *Witt v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 602 F. Supp. 867, 870 (W.D. Pa. 1985); *Universal Marine Insurance Co., Ltd. v. Beacon Insurance Co.*, 588 F. Supp. 735, 738 (W.D.N.C. 1984); *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 605 F. Supp. 510 (W.D. Pa. 1984).

B. Public Policy Concerns Inherent in RICO Actions Preclude Arbitration

Contrary to the transparent *ipse dixit* argument of petitioners that because RICO claims involve commercial disputes somehow they do not implicate public policy,[7] the opposite postulate adheres. As the Second Circuit observed in *McMahon*, in correctly comparing the policy concerns shared in enforcement of both the RICO statute and the antitrust laws:

> "In *American Safety Equipment v. J.P. Maguire*, 391 F.2d 821 (2d Cir. 1968), we stated that '[a] claim under the antitrust laws is not merely a private matter. The Sherman Act is designed to promote the national interest in a competitive economy; thus, the plaintiff asserting his rights under the Act has been likened to a private attorney-general who protects the public's interest.' 391 F.2d at 826. We hold that there are comparable concerns inherent in the enforcement of RICO claims."

McMahon, supra, 788 F.2d at 98.

Moreover, this Court's decision in the *Mitsubishi* case, which arose in the context of an international dispute, was not meant to nor does it emasculate the reasoning of the Second Circuit as applied to agreements to arbitrate in the context of domestic transactions:

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[7] Petition at 25.

> "Enforcement of the RICO statute is particularly appropriate in a judicial forum because of strong policy concerns, the need for development of the record, and judicial clarification and resulting consistency in resolving disputes under this relatively new statute."

McMahon, *supra*, 788 F.2d at 98-99.

Despite petitioners' offhanded characterization of the "typical" RICO claim (*see* Petition at 25-27), the proper development of the law underlying the RICO statute is best left to the courts at this time. Because of the newness of decisions under the RICO statute, and in the absence of congressional clarification or action currently to amend the statute, it is imperative that the courts develop the law under RICO so as to provide the following safeguards, *inter alia*: judicial fact-finding; the rules of procedure and evidence that do not apply in the typical arbitration proceeding; the benefit of a complete record; additional safeguards of appellate review of RICO decisions; judicial expertise in interpreting this relatively new statute; and the deterrent effect of enforcing RICO in the federal courts to protect the public interest. *See generally McDonald v. City of West Branch, Michigan*, U.S., 104 S. Ct. 1799 (1984). Arbitration is simply not an adequate forum for civil enforcement of important federal statutory law and policy. *See*, *e.g.*, *Barrentine v. Arkansas-Best Freight System, Inc.*, 450 U.S. 728 (1981) (employee's claims under Fair Labor Standards Act nonarbitrable); *McDonald v. City of West Branch*, *supra*, (claims under the Klu Klux Klan Civil Rights Act of 1871 nonarbitrable); *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974) (claims under Title VII of Civil Rights Act of 1964 nonarbitrable).

It is no wonder then, in light of the weighty policy concerns supporting litigation of RICO claims, that petitioners mention the holding of this Court in *Sedima*, *supra*, almost as an afterthought.[8] In *Sedima*, this Court recommended that in order to effectuate its remedial purpose, the RICO statute "is to be read broadly." *Sedima*, *supra*, 105 S. Ct. at 3286. Petitioners, however,

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[8] *See* Petition at 18, 22.

argue that an arbitration agreement would probably never arise in a "legitimate" RICO claim. *See* Petition at 27. *Sedima*, however, sets to rest petitioners' thinly veiled implication that organized crime involvement is a necessary element of a claim brought under the RICO statute. And the fact that the RICO claims in this case are predicated upon 1934 Act securities law violations is but a final reason for affirming the Second Circuit's decision that courts and not arbitrators must hear both 1934 Act claims and RICO claims at the same instance.

Because the Congress explicitly intended that RICO claims should have a federal judicial forum and should not be arbitrated, and because of the underlying, significant public policy considerations supporting the litigation of civil RICO claims, the Second Circuit's decision in this regard should be affirmed without hesitation by the Court, and the Petition should be denied.

III. Respondents' Claims Are Not Subject to Arbitration Since the Arbitration Provision of Their Purported "Agreement" Is Inapplicable and the Parties Did Not Intend the Petitioners' Misconduct to be Subject to Any Arbitration Provision, Which in This Case Was Allegedly Procured By Fraud

As was briefed in the appeal before the Second Circuit below, the form of purported customer "agreement" allegedly signed by the individual respondents in connection with their accounts and the accounts of the various trusts were not only prepared by petitioners' alone but were not subject to any negotiation whatsoever between the parties. It is important to keep in mind that the so-called customer agreement containing these standard arbitration clauses is not an agreement as between industry professionals but between brokerage professionals and the ordinary customer with typically no bargaining power as to the contents of the form agreement.

This Court recognized in *Mitsubishi* that "the first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute." *Mitsubishi*, *supra*, 105 S. Ct. at 3354. This Court went on to instruct that "[o]f course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.' " *Id.*, *citing* 9 U.S.C. Section 2; *Southland Corp. v. Keating*, 465 U.S. 1, at ____ n.11, 104 S. Ct., at 861, n.11 (1984); *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15, (1972). Here, as likely happens in the typical relationship between broker-dealers and customers, respondents signed these boilerplate forms as a necessary requirement of beginning the relationship, a mere formality in which the customer is not asked to nor expected to read the small, fine print of the form.

At the time that the purported "agreements," in the form of the standard customer agreement, containing the so-called "arbitration" clause, were entered into by the parties hereto, it is

indisputable that the Circuit Courts of Appeals had uniformly adhered to the position that *Wilko v. Swan* precluded the arbitration of all securities claims, whether arising under the 1933 Act or the 1934 Act. (*See* case law cited hereinabove). As was noted *infra* in respondents' counterstatement of the case, it was not until the concurrence of Justice White appeared in the *Byrd* case that petitioners moved to compel these claims to arbitration in the district court. In fact, petitioners could not rely upon the majority opinion of the Court in the *Byrd* case, since the brokerage firm there did not seek to compel arbitration of federal securities claims but only of pendent state law claims. Thus, respondents should not be held to be bound by a purported "agreement" to arbitrate that was unenforceable at the time it was allegedly entered into by the parties.

Moreover, the purported agreements to arbitrate herein were fraudulently obtained, on two separate grounds. First, the inclusion of the arbitration clause in an agreement such as that at issue in *McMahon* (mandating arbitration in any controversy arising out of disputes between customers and broker-dealers) was as early as 1979 characterized by the SEC as a "fraudulent practice." *See* SEC Act Release No. 15984 (July 2, 1979), 17 SEC Docket 1167 (1979), [1979] Fed. Sec. L. Rep. (CCH) Par. 82,122. (SEC Release, warning broker-dealers that they should make customers aware of rights to a judicial forum to pursue 1933 and 1934 Act claims, notwithstanding arbitration agreements). The SEC since that time has reaffirmed its dim view of mandatory arbitration agreement language by enacting SEC regulation 15c2-2, 17 C.F.R. Section 240.15c2-2. The SEC, in Exchange Act Release No. 20397, clearly determined mandatory arbitration clauses to be "a misleading statement of customers' rights under the federal securities laws." (November 28, 1983) reprinted in [1983-84 transfer binder] Fed. Sec. L. Rep. (CCH) Par. 83,452 at 86,357.[9] Although the latter SEC regulation and release may

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[9] *See, Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 81 L. Ed.2d 694, 703 (1984) ("[Agency] regulations are given controlling weight unless they are arbitrary, capricious or manifestly contrary to the statute.").

have been enacted following the execution of the agreements at issue here, nevertheless, it is important to note that the cumulative effect of the SEC's position apparently is to affirm the extension of *Wilko v. Swan* to claims arising under the 1934 Act making agreements to arbitrate such claims unenforceable.[10]

It is well-settled that the question of whether the arbitration provision at issue here was obtained by fraud is one for a court and not an arbitration panel to deliberate upon and decide. *See Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395, 403-04 (1967). Further, "a court may not order arbitration until it is satisfied that a valid arbitration agreement exists. *See* 9 U.S.C. Section 4." *Miller v. Drexel Burnham Lambert, Inc.*, *supra*, [Current] Fed. Sec. L. Rep. (CCH), Par. 92,783 at 93,858.

The evidence that the purported agreements herein were induced by fraud was not before the district court below, a point that was briefed before the Second Circuit. It is respectfully requested that, in the event this Court renders a summary affirmance herein, the Court should additionally remand for the district court's consideration the question of the fraudulent inducement of the agreements at issue.

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[10] Indeed, petitioners unhesitatingly point to the SEC's manifest "jurisdiction to correct any perceived abuses or unfairness" substantively, vis a vis arbitration rules, citing Section 19 of the 1934 Act, 15 U.S.C. Section 78s. (Petition at 9, n.5).

CONCLUSION

This Court should deny the Petition for a Writ of Certiorari. There is no substantial split in the Circuits on the issues presented herein, and, in fact, almost without exception the Circuits are in agreement in extending the *Wilko* doctrine to 1934 Act claims. To accept *certiorari* at this time would constitute a waste of the precious resources of this Court on a settled issue which only recently has been called into question by one Circuit Court decision. Further, a change at this time in the well-settled law affording purchasers of securities a judicial forum for their federal statutory rights would contravene the clear intent of Congress, established federal policy, the unbroken line of precedents of this Court, and the jurisdictional and non-waiver provisions of the 1934 Act, Section 27 and 29(a), respectively. Moreover, the intent of Congress and overriding public policy concerns mandate that respondents' RICO claims be enforced in the federal judicial forum. Finally, the question as to the validity *ab initio* of the purported "agreements" should be remanded for further consideration by the district court in light of respondents' claim of fraud in the inducement thereof. The decision of the United States Court of Appeals for the Second Circuit should be affirmed herewith. The Petition for a Writ of Certiorari should be denied.

Dated: New York, New York
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No. 86-44

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

REPLY BRIEF OF THE PETITIONERS IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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TABLE OF CONTENTS

	Page
Table of Authorities	ii
Argument	1
I. The Fully-Developed Conflict Among the Circuits Regarding the Arbitrability of § 10(b) Claims Warrants Immediate Resolution By This Court	3
II. The Third Circuit's Recent Decision in *Jacobson* Has Created a Conflict Between the Second and Third Circuits Regarding the Arbitrability of Civil RICO Claims	7
III. Respondents' Arguments Concerning the Enforceability of their Various Arbitration Agreements Should Not be Considered by This Court	8
Conclusion	10

TABLE OF AUTHORITIES

Cases	Page
American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968)	2
Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976)	5
Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520 (9th Cir. 1986)	2, 5, 6
Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 105 S. Ct. 1238 (1985)	*passim*
Hirschey v. F.E.R.C., 777 F.2d 1 (D.C. Cir. 1985)	6
Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., Nos. 85-3282, 85-3311 and 85-3343 (3d Cir. Aug. 11, 1986)	*passim*
King v. Drexel Burnham Lambert, Inc., No. 85-1717 (5th Cir. 1986)	4, 5
McMahon v. Shearson/American Express, Inc., 788 F.2d 94 (1986)	*passim*
Miller v. Drexel Burnham Lambert, Inc., 791 F.2d 850 (11th Cir. 1986) (per curiam)	4
Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 105 S. Ct. 3346 (1985)	3, 4, 5
Moran v. Paine, Webber, Jackson & Curtis, 389 F.2d 242 (3d Cir. 1968)	5
Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983)	3

Page

Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 795 F.2d 1393, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92, 815 (8th Cir. July 9, 1986) ..... *passim*

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967) 3

Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974) 3

Southland Corp. v. Keating, 465 U.S. 1 (1984) ... 3

Wilko v. Swan, 346 U.S. 427 (1953) 4, 5, 6

Statutes

Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.* (1982) 2

Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (1982) 1

United States Arbitration Act, 9 U.S.C. § 1 *et seq.* (1982) 2, 7

Other Materials

H.R. Rep. No. 229, 94th Cong., 1st Sess. 111, *reprinted in* 1975 U.S. Code Cong. & Ad. News 321, 342 6

United States Supreme Court Rules, 17.1(a), 28 U.S.C.A. 2

United States Supreme Court Rules, 17.1(c), 28 U.S.C.A. 2

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REPLY BRIEF OF THE PETITIONERS IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

ARGUMENT

Respondents in their Brief in Opposition examine the direct conflict among the circuits regarding the arbitrability of § 10(b)[1] claims and conclude that there exists only an "apparent conflict", which "is neither substantial nor important enough to warrant this Court's plenary review." Brief in Opposition ("Opp.") at 7. This strained conclusion defies comprehension. While respondents correctly concede that the conflict between the Second Circuit and the Eighth Circuit Courts of Appeals serves

[1] Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78a *et seq.* (1982).

as an independent basis for this Court to grant a writ of certiorari to review the arbitrability of § 10(b) claims, they incorrectly downplay the significance of the conflict and ignore the fact that this Court's review is also warranted because the Second Circuit decided important questions of federal law which have not been, but should be, settled by this Court. *See* U.S. Sup. Ct. Rules 17.1(a) and (c), 28 U.S.C.A. This Court has never expressly ruled on the application of the United States Arbitration Act[2] to § 10(b) claims, notwithstanding respondents' contention to the contrary. Opp. at 4-6.

The need for immediate resolution of the conflict created by the Second Circuit in *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986), and the Eighth Circuit in *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92, 815 (8th Cir. July 9, 1986), has increased since the Petition was filed with this Court on July 14, 1986. On July 17, 1986, the Ninth Circuit Court of Appeals in *Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520 (9th Cir. 1986), held that § 10(b) claims are not arbitrable. This decision creates a direct conflict with the Eighth Circuit Court of Appeals in *Phillips*, which concluded eight days earlier that § 10(b) claims are arbitrable. Furthermore, on August 11, 1986, the Third Circuit Court of Appeals in *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Nos. 85-3282, 85-3311 and 85-3343 (3d Cir. Aug. 11, 1986), adhered to its controlling precedent that § 10(b) claims are not arbitrable, also creating a direct conflict with the Eighth Circuit.

In addition to the conflict among the circuits which exists as to the arbitrability of § 10(b) claims, the Third Circuit Court of Appeals on August 11, 1986, in *Jacobson*, expressly rejected the *American Safety* rationale [3] underlying the Second Circuit's holding in *McMahon* that RICO claims [4] are never arbitrable,

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[2] 9 U.S.C. § 1 *et seq.* (1982).

[3] See American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968).

[4] Claims brought under § 1964 of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1961 *et seq.* (1982).

and held that RICO claims are arbitrable except in those situations where the underlying predicate offenses are not arbitrable. As the Third Circuit stated, their holding creates a direct conflict between the Second Circuit and the Third Circuit regarding the issue of RICO's arbitrability:

> Our holding that RICO claims based on nonarbitrable predicate offenses are not arbitrable conflicts with the holding of the Court of Appeals for the Second Circuit in *McMahon v. Shearson/American Express Inc.*, 788 F.2d 94 (2d Cir. 1986).

Jacobson, slip op. at 7.

The issues presented in the Petition are at least as important as any of the arbitral issues this Court has reviewed in recent years. *See Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 105 S. Ct. 1238 (1985) (whether arbitrable pendent claims may be "intertwined" with non-arbitrable claims in the same forum); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985) (arbitrability of antitrust claims in international context); *Southland Corp. v. Keating*, 465 U.S. 1 (1984) (enforceability of California franchise law which invalidated arbitration agreements); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983) (propriety of staying a federal action in deference to a parallel litigation in state court); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974) (arbitrability of § 10(b) claims in international context); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (whether federal court or arbitrator is to resolve claim of "fraud in the inducement" of a contract). Accordingly, petitioners submit that the arbitrability of § 10(b) and RICO claims are issues warranting this Court's immediate plenary review.

I. The Fully Developed Conflict Among the Circuits Regarding the Arbitrability of § 10(b) Claims Warrants Immediate Resolution by This Court

In support of their argument that the conflict created by *Phillips* is "neither substantial nor important", respondents stress the fact that numerous other circuit court decisions have, unlike the Eighth Circuit in *Phillips*, ruled that § 10(b) claims are not arbitrable. Opp. at 7. This argument is superficially appealing but lacks substance. All but two of the circuit courts of appeals

which have addressed this issue since this Court's decision in *Byrd* have simply followed controlling precedents that were established at a time when it was assumed that this Court's holding in *Wilko*[5] extended to Exchange Act claims. These precedents were all established prior to this Court's recent holdings in *Byrd* and *Mitsubishi*, which reaffirmed the strong national policy favoring arbitration and enunciated strict guidelines to be followed when construing a statute's arbitrability.

For example, in *McMahon*, the Second Circuit's deference to its controlling precedent is evidenced in the following passage:

> Although *Scherk* and *Byrd* may cast some doubt on whether the Supreme Court, if presented with the issue, would hold claims under § 10(b) and Rule 10b-5 to be non-arbitrable, it would be improvident for us to disregard clear judicial precedent in this Circuit based on mere speculation.

McMahon, 788 F.2d at 98.

In *Miller v. Drexel Burnham Lambert, Inc.*, 791 F.2d 850 (11th Cir. 1986) (per curiam), the Eleventh Circuit Court of Appeals, in holding § 10(b) claims non-arbitrable stated:

> Under the rule of *Belke* [*v. Merrill Lynch, Pierce, Fenner & Smith*, 693 F.2d 1023 (11th Cir. 1982)], *supra*, no claims based on the federal securities acts are arbitrable. . . . *Belke* remains the law of this circuit. . . .

Id., at 854.

In *King v. Drexel Burnham Lambert, Inc.*, No. 85-1717 (5th Cir. May 28, 1986), the Fifth Circuit, in a two-page opinion held:

> The rule in this Circuit is clear: The doctrine of *Wilko v. Swan*, . . . which holds that any agreement to

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[5]*Wilko v. Swan*, 346 U.S. 427 (1953).

> arbitrate claims arising under the Securities Act of 1933 is invalid, is equally applicable to claims arising under the Exchange Act of 1934, ... Our decisions in *Sawyer* and *Sibley* retain their full precedential authority, authority we are *obliged* to follow.

Id., slip op. at 2-3. (citation omitted) (emphasis added).

In *Jacobson*, the Third Circuit considered itself bound by precedent holding § 10(b) claims not arbitrable. The Third Circuit held that their precedents of *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976), and *Moran v. Paine, Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968), precluded them from holding § 10(b) claims arbitrable. *Jacobson*, slip op. at 12-14. Therefore, the assumption that the doctrine of *Wilko v. Swan* (claims under § 12(2) of the Securities Act of 1933 not arbitrable) mechanically applies to § 10(b) claims has unfortunately retained vitality, primarily because most of the circuit courts of appeals feel powerless to hold otherwise absent this Court's intervention.

In reality, only the Eighth Circuit in *Phillips* and the Ninth Circuit in *Conover* have examined the issue of § 10(b)'s arbitrability free from the restraint of prior controlling precedent and in light of this Court's recent holdings in *Byrd* and *Mitsubishi*. These circuit courts of appeals are in direct conflict over the merits of this issue. For example, the Ninth Circuit in *Conover*, as well as respondents in their Brief in Opposition, cite a 1979 SEC release requiring broker-dealers to notify their customers that they have a non-waivable right to a judicial forum in certain instances, in support of the contention that § 10(b) claims are not arbitrable. 794 F.2d at 524; Opp. at 21-22. The Eighth Circuit in *Phillips* expressly disagreed stating:

> . . . [I]n adopting Regulation 15c2-2 the SEC intended only to reflect what it believed to be a settled principle of law (i.e. that predispute arbitration agreements

> are unenforceable under both the 1933 Act and the 1934 Act). As this opinion indicates, the SEC was mistaken.

Phillips, Fed. Sec. L. Rep. ¶ 92,815 at 93,991 n. 17.

Additionally, the Ninth Circuit and respondents conclude that language in a House Conference Report to the 1975 amendments to the Exchange Act evidences Congressional intent to preclude arbitration of § 10(b) claims. The House Conference Report dealt solely with member firm arbitration, and contained a sentence stating that it "did not change existing law, as articulated in *Wilko v. Swan*." *Conover*, 794 F.2d at 524, *citing* H.R. Rep. No. 229, 94th Cong., 1st Sess. 111, *reprinted in* 1975 U.S. Code Cong. & Ad. News 321, 342; *see* Opp. at 14-15. The Eighth Circuit, in expressly rejecting this argument, declined to give weight to what it labelled a single "ambiguous sentence". *Phillips*, Fed. Sec. L. Rep. ¶ 92,815 at 93,991 n. 17. *Cf. Hirschey v. F.E.R.C.*, 777 F.2d 1, 7-8 (D.C. Cir. 1985) (Scalia, J., concurring) (criticizing routine deference to the detail of congressional committee reports).

The result of the clear and direct conflict among the circuits is best expressed by the Eighth Circuit:

> We believe . . . that the Supreme Court's opinions in *Scherk* and *Byrd* have invited a reexamination of the applicability of *Wilko* to claims arising under section 10(b) of the 1934 Act and Rule 10b-5. Because we are not bound by the precedents of other circuits, we are free to make a new assessment of this issue. We have made that assessment, and now create a conflict within the circuits. We assume the Supreme Court will eventually decide this question.

Phillips, Fed. Sec. L. Rep. ¶ 92,815 at 93,992.

Moreover, as Judge Adams noted in his dissent to the Third Circuit's opinion in *Jacobson*:

> Because of the split in the circuits and the reservations in *Scherk* and *Ayres*, however, some uncertainty

> necessarily will remain until the Supreme Court speaks authoritatively to this issue. Since commercial relations affecting thousands of investors and scores of brokerage houses will remain in the shadow of doubt until then, an early definitive decision by the Supreme Court would be a helpful development.

Jacobson, slip op. at 23-24 (Adams, J., concurring in part and dissenting in part).

Although the circuit courts of appeals have fully developed the issue of the arbitrability of § 10(b) claims, they are powerless to resolve the conflict. Only this Court can end the imbroglio, and it should do so without delay.

II. The Third Circuit's Recent Decision in *Jacobson* Has Created a Conflict Between the Second and Third Circuits Regarding the Arbitrability of Civil RICO Claims

Respondents, in their Brief in Opposition, argue that RICO claims should be exempt from the United States Arbitration Act citing general "public policy concerns" and concluding, without any support whatsoever, that Congress "explicitly" intended that RICO claims should not be arbitrated. Opp. at 16-19. This argument is unsupported by the RICO statute, its legislative history or this Court's precedent.

The same arguments raised by respondents were recently rejected by the Third Circuit Court of Appeals in *Jacobson*, which, within days of respondents' filing of their Brief in Opposition, examined and rejected the "public policy" rationale of *McMahon* and created a conflict between the circuits regarding the issue of RICO's arbitrability. *Jacobson*, slip op. at 14-15. The Third Circuit in *Jacobson* expressly noted the lack of Congressional intent to prohibit arbitration of RICO claims and held that all RICO claims are arbitrable unless based upon non-arbitrable predicate acts. *Id*. Accordingly, the Third Circuit held that RICO claims predicated upon mail fraud or wire fraud are arbitrable. However, as an exception to its general rule that all RICO claims are arbitrable, the Third Circuit held that RICO claims

predicated on violations of § 10(b) cannot be arbitrated due to its controlling prior precedent that § 10(b) claims are not arbitrable. *Id.* at 15-16. As the Third Circuit stated, its holding "conflicts with the holding of the Court of Appeals for the Second Circuit . . .," which held that all civil RICO claims are not arbitrable because of public policy considerations. *Id.* at 7 n.2, 14-15.

The conflict created by the Third Circuit further mandates review by this Court because its decision will cause even more confusion among the lower courts. The result of the *Jacobson* holding is that when a plaintiff in a federal securities case alleges violations of state and common law, § 10(b) and RICO based upon mail, wire and securities fraud, as is commonplace: (1) his § 10(b) claim will be heard in a federal court; (2) his state and common law claims will be heard in an arbitral forum; (3) his RICO claim based on § 10(b) violations will be heard in federal court; and (4) his RICO claim based on mail and wire fraud will be heard in an arbitral forum. This result, with its attendant motion practice and collateral estoppel problems, wastes the precious and limited resources of the federal court system, greatly increases the cost and time expense of litigants, and exacerbates the disorder already present in the lower courts. The situation will continue to worsen with the passage of time, and only this Court can resolve the problem.

III. Respondents' Arguments Concerning the Enforceability of Their Various Arbitration Agreements Should not be Considered by This Court

In a misguided effort to cause this Court to deny petitioners' request that a writ of certiorari issue to review the arbitrability of § 10(b) and RICO claims, respondents claim that the arbitration agreements they entered into with petitioners are unenforceable. Opp. at 20-22. This argument was summarily dismissed by the Second Circuit in a footnote. *McMahon*, 788 F.2d at 99 n.6. More importantly, respondents concede that "[t]he evidence that the purported agreements herein were induced by fraud was not before the district court below...." Opp. at 22. For that reason alone, this Court should not address this issue.

In *Byrd*, the respondent made a similar attempt to circumvent the merits of the case by arguing that the arbitration agreement was a product of an adhesion contract and thus unenforceable. As this Court ruled:

> Respondent Byrd also argues that as a contract of adhesion this arbitration agreement is subject to close judicial scrutiny, and that it should not routinely be enforced. Byrd did not present this argument to the courts below, and we decline to address it in the first instance. We therefore express no view on the merits of the argument.

Byrd, 105 S. Ct. at 1240 n.2.

Since the respondents failed to present the district court with any evidence to preclude the enforceability of the arbitration agreements, this point in opposition should not be considered.

CONCLUSION

For all of the foregoing reasons, petitioners respectfully request that this Court issue a writ of certiorari in this case to review the decision of the United States Court of Appeals for the Second Circuit.

DATED: NEW YORK, NEW YORK
August 28, 1986

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS, INC., and MARY ANN MCNULTY,

Petitioners,

—v.—

EUGENE MCMAHON, JULIA MCMAHON, individually and as Trustees of the DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

BRIEF OF *AMICI CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF *CERTIORARI*

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as *Amici Curiae*

TABLE OF CONTENTS

PAGE

Table of Authorities iii

Brief *Amici Curiae*

Preliminary Statement 1

Interest of *Amici Curiae* 2

Reasons for Granting a Writ of *Certiorari*

Summary of Argument 3

ARGUMENT

I. Arbitration Should be Recognized as an Efficient and Widely Accepted Means of Resolving Broker-Customer Disputes in the Securities Industry..... 5

II. The Second Circuit's Opinion on RICO Ignored the Standard for Finding an Implied Repeal of the United States Arbitration Act.. 11

III. The Second Circuit Failed to Reexamine Its Extension of *Wilko* v. *Swan* to Claims Arising Under Section 10(b) of the Securities Exchange Act of 1934 in Light of This Court's Opinions in *Scherk* v. *Alberto-Culver Co.*, *Dean Witter Reynolds Inc.* v. *Byrd*, and *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*..... 13

IV. The Circuits Stand in Conflict as to the Arbitrability of Claims Arising Under Section 10(b) and RICO..... 15

CONCLUSION..... 16

PAGE

Appendices

A. Uniform Code of Arbitration A1

B. Annual Report of the Director of Administrative Office of the United States Courts, Table 19 (1985)..... A17

C. Fifth Report of the Securities Industry Conference on Arbitration, Statistical Report (April 1986) ... A23

Supplemental Lodging of *Amici Curiae*

Part I

American Stock Exchange, Inc., Arbitration Rules 1

Part II

New York Stock Exchange, Inc., Arbitration Rules 12

Part III

Uniform Code of Arbitration Procedure of the National Association of Securities Dealers, Inc... 24

Part IV

American Stock Exchange, Inc., Panel of Arbitrators..... 39

TABLE OF AUTHORITIES

Cases: PAGE

Allen v. *McCurry*, 449 U.S. 90 (1980) 11

American Safety Equipment Corp. v. *J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) 12n

AVC Nederland B.V. v. *Atrium Inv. Partnership*, 740 F.2d 148 (2d Cir. 1984) 8,15n

Axelrod & Co. v. *Kordich, Victor & Neufeld*, 320 F. Supp. 193 (S.D.N.Y. 1970), *aff'd*, 451 F.2d 838 (2d Cir. 1971) 8

Brown v. *Gilligan, Will & Co.*, 287 F. Supp. 766 (S.D.N.Y. 1968) 8

Conover v. *Dean Witter Reynolds, Inc.*, No. 85-6082 (9th Cir. July 17, 1986) 4n, 16

Dean Witter Reynolds Inc. v. *Byrd*, ____ U.S. ____, 105 S. Ct. 1238 (1985) ..... *passim*

Gardner v. *Shearson, Hammill & Co.*, 433 F.2d 367 (5th Cir. 1970) (per curiam), *cert. denied*, 401 U.S. 978 (1971) 8

Kaiser Steel Corp. v. *Mullins*, 455 U.S. 72 (1982) ...4, 11, 14

McMahon v. *Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986) ..... *passim*

Miller v. *Drexel Burnham Lambert, Inc.*, No. 85-5692 (11th Cir. June 17, 1986) 15

Mitsubishi Motors Corp. v. *Soler Chrysler-Plymouth*, ____ U.S. ____, 105 S. Ct. 3346 (1985) ..... *passim*

Moran v. *Paine, Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968) 8

Morton v. *Mancari*, 417 U.S. 535 (1974) 4, 11, 14

PAGE

Moses H. Cone Memorial Hospital v. *Mercury Constr. Corp.*, 460 U.S. 1 (1983) ..... *passim*

Phillips v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, No. 85-5156 (8th Cir. July 9, 1986) 5, 10, 15

Scherk v. *Alberto-Culver Co.*, 417 U.S. 506 (1974) ... *passim*

Sedima, S.P.R.L. v. *Imrex Co.*, ___ U.S. ___, 105 S. Ct. 3275 (1985) 12n

Southland Corp. v. *Keating*, 465 U.S. 1 (1984) ..... *passim*

Wilko v. *Swan*, 346 U.S. 427 (1953)..... *passim*

Statutes:

Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1962-1964 ..... *passim*

Securities Act of 1933,
Section 12(2), 15 U.S.C. § 77*l*(2) 13, 14
Section 14, 15 U.S.C. § 77n. 13
Section 22, 15 U.S.C. § 77v..... 13

Securities Exchange Act of 1934,
Section 10(b), 15 U.S.C. § 78j(b) ..... *passim*
Section 19, 15 U.S.C. § 78s 7

United States Arbitration Act,
Section 2, 9 U.S.C. § 2..... *passim*

Rules:

American Stock Exchange, Inc., Arbitration Rules, 2 Am. Stock Ex. Guide (CCH) ¶¶ 9540-9551J.....6n, 7n, 9n

Constitution of the New York Stock Exchange, Inc., Art. VIII, 2 N.Y.S.E. Guide (CCH) ¶¶ 1351-1357.... 7n

New York Stock Exchange, Inc., Arbitration Rules, 2 N.Y.S.E. Guide (CCH) ¶¶ 2600-2634 .....6n, 7n, 9n

PAGE

Uniform Code of Arbitration, *reprinted in* Fifth Report of the Securities Industry Conference on Arbitration (April 1986) (Exhibit C) 6n, 7n, 8n, 9n

Uniform Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., N.A.S.D. Manual (CCH) ¶¶ 3701-3743 ..... 6n, 7n, 8n, 9n

Articles:

C. Katsoris, *The Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279 (1984) 9

Miscellaneous:

American Stock Exchange, Inc., Panel of Arbitrators 1986-1987, 1 Am. Stock Ex. Guide (CCH) ¶¶ 157-59 8n

Annual Report of the Director of Administrative Office of the United States Courts, Table 19 (1985) 10n

Fifth Report of the Securities Industry Conference on Arbitration, Statistical Report (April 1986) (Exhibit A) 8n, 9n

SEC Securities Exchange Act Release No. 16390, (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979) 7

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

No. 86-46

SHEARSON/AMERICAN EXPRESS, INC., and
MARY ANN MCNULTY,

Petitioners,

—v.—

EUGENE MCMAHON, JULIA MCMAHON, individually and as Trustees of the DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

BRIEF OF *AMICI CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF *CERTIORARI*

PRELIMINARY STATEMENT

The Securities Industry Association, Inc. ("SIA"), A. G. Edwards & Sons, Inc. ("A. G. Edwards"), Advest, Inc. ("Advest"), Alex. Brown & Sons Incorporated ("Alex. Brown"), Bateman Eichler, Hill Richards Incorporated ("Bateman Eichler"), The Chicago Corporation ("The Chicago Corporation"), Dean Witter Reynolds, Inc. ("Dean Witter"), Dominick & Dominick, Incorporated ("Dominick"), Goldman, Sachs & Co. ("Goldman"), Howard, Weil, Labouisse, Friedrichs Inc. ("Howard Weil"), J. C. Bradford & Co. ("J. C. Bradford"),

Johnston, Lemon & Co. Incorporated ("Johnston Lemon"), Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), Moseley Securities Corporation ("Moseley"), Nomura Securities International, Inc. ("Nomura"), Piper, Jaffray & Hopwood Incorporated ("Piper Jaffray"), Prescott, Ball & Turben, Inc. ("Prescott Ball"), Rauscher Pierce Refsnes, Inc. ("Rauscher Pierce"), Raymond, James & Associates, Inc. ("Raymond James"), and Wheat, First Securities, Inc. ("Wheat First"), submit this brief as *amici curiae* in support of the Petitioner, and urge this Court to issue a writ of *certiorari* to the United States Court of Appeals for the Second Circuit with respect to the opinion and judgment of the Second Circuit below in *McMahon* v. *Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986). Pursuant to Rule 36.1 of the Rules of this Court, the written consent of petitioners Shearson/American Express, Inc., and Mary Ann McNulty and respondents Eugene and Julia McMahon, individually and as Trustees of The David J. Hodder & Son, Inc. Employee Pension Plan, The David J. Hodder & Son Profit Sharing Plan, The Laurie Funeral Home, Inc. Employee Pension Plan, and The Laurie Funeral Home Profit Sharing Plan, has been obtained and has been filed with the Clerk of the Court.

INTEREST OF *AMICI CURIAE*

SIA is the principal trade association of the securities industry, having as members more than five hundred securities firms in the United States and Canada. As such, it has a substantial interest in the extent to which agreements to arbitrate claims between securities firms and their customers may be enforced. Because arbitration is an efficient, fair, and economical manner of resolving disputes, most of SIA's members have agreed with many of their customers to arbitrate any controversies arising between them. Among these members are *amici curiae* A. G. Edwards, Advest, Alex. Brown, Bateman Eichler, The Chicago Corporation, Dean Witter, Dominick,

Goldman, Howard Weil, J. C. Bradford, Johnston Lemon, Merrill Lynch, Moseley, Nomura, Piper Jaffray, Prescott Ball, Rauscher Pierce, Raymond James, and Wheat First.

Certain *amici* are parties to cases pending in the lower federal courts that involve one or both of the issues presented on this petition. The procedural outcome of those actions will be affected by any decision taken by this Court in this petition. *Amici curiae* therefore have a substantial interest in seeing this Court resolve whether agreements to arbitrate claims arising under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1962-64 ("RICO"), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (the "Exchange Act"), are enforceable as valid contracts under Section 2 of the United States Arbitration Act, 9 U.S.C. § 2 (the "Arbitration Act"). *Amici* seek to clarify and make uniform the law on these issues so that the enforceability of arbitration provisions in agreements with their customers can be predicted and relied upon. SIA has also filed briefs *amicus curiae* on these issues to this Court in *Dean Witter Reynolds Inc.* v. *Byrd*, ____ U.S. ____, 105 S. Ct. 1238 (1985) to the Second Circuit below, and to the Second, Third, Sixth, Eighth, Ninth, and Eleventh Circuits in other actions.

REASONS FOR GRANTING A WRIT OF *CERTIORARI*

SUMMARY OF ARGUMENT

The opinion of the United States Court of Appeals for the Second Circuit below, *McMahon* v. *Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986), which held that predispute arbitration agreements are unenforceable with respect to both RICO and Section 10(b) claims, reflects the suspicion courts once held of the arbitral process, *see Wilko* v. *Swan*, 346 U.S. 427 (1953), as opposed to the congressionally enacted federal policy recognizing arbitration as an efficient means of resolving disputes. *See Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, ____ U.S. ____, 105 S. Ct. 3346

(1985); *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984); *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. 1 (1983). In *McMahon*, the Second Circuit declined to apply the correct standard for determining whether RICO and Section 10(b) repealed the Arbitration Act by implication, as articulated by this Court in *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. 72 (1982), and *Morton* v. *Mancari*, 417 U.S. 535 (1974). Rather than searching for statutory language conflicting with the Arbitration Act or legislative history indicating congressional intent to repeal the Arbitration Act, as required by *Mitsubishi*, the Second Circuit overruled the substantive, congressional policies embodied in the Arbitration Act solely on the basis of its own conception of public policy.

There are at least one hundred and twenty-nine cases pending in the lower federal courts in which a motion to compel arbitration of a RICO or Section 10(b) claim has been filed.[1] The opinion of the Second Circuit, which substituted that court's policy judgments for those of Congress, can only lead lower courts to stray from the rule laid down by this Court:[2] that the Arbitration Act is valid except where *Congress* has expressed its intention, either in statutory language or legislative history, to repeal it. It may also encourage unscrupulous parties to cast ordinary broker-customer disputes in terms of RICO and Section 10(b) as a device to escape arbitration, which would frustrate the substantive rights established by the Arbitration Act.

Finally, a writ of *certiorari* is appropriate because there exists a split in the circuits. On July 9, 1986, the Eighth Circuit following this Court's analysis in *Mitsubishi* and *Southland*, held that claims arising under Section 10(b) and RICO were arbitrable and enforced a predispute agreement to arbitrate

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1 *See* Petition for *certiorari*, Appendices E and F.

2 *See, e.g., Conover* v. *Dean Witter Reynolds, Inc.*, No. 85-6082, slip op. at 5 (9th Cir. July 17, 1986).

between a broker-dealer and a public customer. *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, No. 85-5156 (8th Cir. July 9, 1986). In *Phillips* the Eighth Circuit recognized the conflict among the circuits and expressed its hope that this Court would resolve the question.

Amici respectfully submit that the petition for *certiorari* should be granted in order to prevent chaos among the lower courts that are trying to define the scope and validity of the Arbitration Act.

POINT I

ARBITRATION SHOULD BE RECOGNIZED AS AN EFFICIENT AND WIDELY ACCEPTED MEANS OF RESOLVING BROKER-CUSTOMER DISPUTES IN THE SECURITIES INDUSTRY

The Second Circuit's opinion ignored the strong federal policy favoring arbitration. To the contrary, inherent in that opinion was the assumption that arbitration of RICO and Section 10(b) claims will somehow undermine substantive rights under those statutes. 788 F.2d at 98 ("[W]e have recognized the inappropriateness of the United States Arbitration Act when strong public policy considerations are involved"). This assumption is untenable as a matter of law and as a matter of fact. Federal policy, embodied in the provisions of the Arbitration Act and construed in the decisions of this Court, unequivocally favors arbitration as a means of resolving disputes. This Court observed in *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*:

> [W]e are well past the time when judicial suspicion of the desirability of arbitration and the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.

105 S. Ct. at 3354. *Accord Moses H. Cone Memorial Hospital* v. *Mercury Constr. Corp.*, 460 U.S. at 24 (Arbitration Act "is

a congressional declaration of a liberal federal policy favoring arbitration . . . [and] questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration"); *Southland Corp.* v. *Keating*, 465 U.S. at 10 (in passing the Arbitration Act, "Congress declared a national policy favoring arbitration . . . [that] mandated the enforcement of arbitration agreements"); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974). *See also Wilko* v. *Swan*, 346 U.S. at 439 (Frankfurter, J., dissenting) ("[t]here is nothing in the record . . . to indicate that the arbitral system . . . would not afford the plaintiff the rights to which he is entitled").[3]

The established structure of arbitration in the securities industry refutes the Second Circuit's assumption that the enforcement of contracts to arbitrate securities disputes is inconsistent with the protection of investors under the securities laws. Securities exchanges and the National Association of Securities Dealers, Inc. (the "N.A.S.D."), under the supervision of the Securities and Exchange Commission, provide arbitration facilities for disputes between member firms and their public customers.[4] The current procedures have evolved since 1872, when the New York Stock Exchange, Inc. first adopted arbitration procedures. The N.A.S.D. has maintained arbitration facilities for more than forty years. The exchanges and the N.A.S.D. maintain permanent arbitration staffs and have codified arbitration procedures in their rules and constitu-

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3 The language in *Mitsubishi*, *Moses Cone*, and *Southland*, which echoes Justice Frankfurter's dissenting language in *Wilko*, 346 U.S. at 439, rather than the majority's concern in *Wilko* that arbitration of Section 12(2) claims would endanger the "special rights" created thereby, 346 U.S. at 435, suggests that the policy underpinnings of *Wilko* no longer retain the same force as when *Wilko* was decided.

4 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542 (Rule 602); N.A.S.D. Manual (CCH) ¶ 3701; 2 N.Y.S.E. Guide (CCH) ¶ 2600 (Rule 600); Uniform Code of Arbitration § 1, *reprinted in* Fifth Report of the Securities Industry Conference on Arbitration, (April 1986) (Exhibit C).

tions.[5] The current arbitration procedures were proposed by the Securities Industry Committee on Arbitration and adopted by the exchanges and the N.A.S.D. Moreover, the Securities and Exchange Commission has approved the implementation and operation of this arbitral system, *see* SEC Securities Exchange Act Release No. 16390 (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979), and retains jurisdiction to monitor the fairness of arbitration proceedings. *See* Section 19 of the Exchange Act, 15 U.S.C. § 78s.

The arbitration rules further ensure that arbitration practice in the securities industry will be efficient and impartial. For example, these rules require that panels of arbitrators include members of the securities industry and of the public.[6] Those rules require a majority of "public" arbitrators (i.e., unaffiliated with member firms) in disputes between public customers and member firms.[7] Arbitrators are required to disclose any business affiliation with any parties before them, and may be disqualified for cause for even the appearance of a conflict of interest.[8] Moreover, each party in an arbitration has at least

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5 *See, e.g.*, Constitution of the New York Stock Exchange, Inc., Art. VIII, 2 N.Y.S.E. Guide (CCH) ¶¶ 1351-1357; Rules 600-634 of the New York Stock Exchange, Inc., *id.* ¶¶ 2600-2634; Uniform Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., N.A.S.D. Manual (CCH) ¶¶ 3701-3743; Arbitration Rules of the American Stock Exchange, Inc., 2 Am. Stock Ex. Guide (CCH) ¶¶ 9540-9551J. The Uniform Code of Arbitration is annexed hereto as Appendix A. Copies of the American Stock Exchange, Inc. Arbitration Rules, the New York Stock Exchange, Inc. Arbitration Rules, and the Uniform Code of Arbitration of the National Association of Securities Dealers, Inc. are contained in Parts I, II, and III of the Supplemental Lodging of *Amici Curiae*, respectively.

6 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9541 (Rule 601); N.A.S.D. Manual (CCH) ¶ 3719; 2 N.Y.S.E Guide (CCH) ¶ 2607 (Rule 607); Uniform Code of Arbitration § 8.

7 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542 (Rule 602); N.A.S.D. Manual (CCH) ¶ 3719; 2 N.Y.S.E. Guide (CCH) ¶ 2607 (Rule 607); Uniform Code of Arbitration § 8.

8 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542(f) (Rule 602(f)); N.A.S.D. Manual (CCH) ¶ 3723; 2 N.Y.S.E. Guide (CCH) ¶ 2610 (Rule 610); Uniform Code of Arbitration § 11.

one peremptory challenge.[9] The fairness of these rules and procedures is borne out by the results of arbitrations conducted under them. In 1985, 55% of public customer cases that went to arbitration before one of the stock exchanges or the N.A.S.D. and were decided—rather than being settled—awarded damages to the customer.[10]

The long established competence of securities industry arbitrators to adjudicate disputes should dispel any suspicion of the arbitral process. The stock exchanges and the N.A.S.D. maintain lists of senior securities industry personnel, attorneys and other professionals from outside the industry, but who are well versed in the field, from which a particular panel may be drawn.[11] Most have previously served as arbitrators and are therefore well acquainted with arbitration procedures and customs. Indeed, the federal courts have recognized securities industry arbitrators as qualified to resolve Section 10(b) and RICO claims. For example, courts have long compelled arbitration of Section 10(b) disputes between members of a securities exchange or the N.A.S.D. *See, e.g., Axelrod & Co.* v. *Kordich, Victor & Neufeld*, 320 F. Supp. 193 (S.D.N.Y. 1970), *aff'd*, 451 F.2d 838 (2d Cir. 1971); *Brown* v. *Gilligan, Will & Co.*, 287 F. Supp. 766, 772 (S.D.N.Y. 1968). Claims under Section 10(b) routinely have been arbitrated in those instances when the public customer chose to arbitrate. *Gardner* v. *Shearson, Hammill & Co.*, 433 F.2d 367 (5th Cir. 1970) (per curiam), *cert. denied*, 401 U.S. 978 (1971); *Moran* v. *Paine, Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968); *cf. AVC Nederland B.V.* v. *Atrium Inv. Partnership*, 740 F.2d 148 (2d Cir. 1984) (affirming the dismissal of a Section 10(b) claim

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9 *See, e.g.*, Uniform Code of Arbitration § 10.

10 Fifth Report of the Securities Industry Conference on Arbitration, Statistical Report (April 1986) (Exhibit A). A copy of the Statistical Report is annexed hereto as Appendix C.

11 *See, e.g.*, Panel of Arbitrators 1986-1987, 1 Am. Stock Ex. Guide (CCH) 157-59; N.A.S.D. Manual (CCH) ¶ 3702. A copy of the American Stock Exchange, Inc. Panel of Arbitrators is contained in Part IV of the Supplemental Lodging of *Amici Curiae*.

because the parties had agreed to try all disputes in the Netherlands).

Moreover, the arbitration process significantly reduces discovery expenses and minimizes delay in reaching a hearing. *See* C. Katsoris, *The Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279, 286 (1984). For example, state laws generally provide subpoena power to arbitrators and counsel, and parties are encouraged to produce documents "to the fullest extent possible without resort to the issuance of the subpoena process."[12] Arbitrators may also direct the appearance of persons associated with member organizations or the production of records of these organizations without using the subpoena process.[13] That most stock exchanges and the N.A.S.D. offer a streamlined arbitration procedure for smaller claims also enables customers to resolve small disputes without incurring great expense.[14] According to statistics compiled by the Securities Industry Conference on Arbitration, nearly 2800 securities industry arbitrations were filed with stock exchanges and the N.A.S.D. in 1985, and 2190 arbitrations in the securities industry were resolved during that year.[15] The 1985 figures show that more than twice the number of arbitrations were filed that year than in 1982.[16]

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12 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9548 (Rule 608); N.A.S.D. Manual (CCH) ¶ 3732; 2 N.Y.S.E. Guide (CCH) ¶ 2619 (Rule 619); Uniform Code of Arbitration § 20; C. Katsoris, *supra*, at 286.

13 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9549 (Rule 609); N.A.S.D. Manual (CCH) ¶ 3733; 2 N.Y.S.E. Guide (CCH) ¶ 2620 (Rule 620); Uniform Code of Arbitration § 21.

14 *See, e.g.*, 2 Am. Stock Ex. Guide ¶ 9551H (Rule 619); N.A.S.D. Manual (CCH) ¶ 3710; 2 N.Y.S.E. Guide ¶ 2601 (Rule 601); Uniform Code of Arbitration § 2.

15 *See* Fifth Report of the Securities Industry Conference on Arbitration, Statistical Report (April 1986) (Exhibit A).

16 The number of filings rose from 1340 in 1982 to 2796 in 1985. *See id.*

Any lingering suspicion as to the efficiency and fairness of arbitration as a means of resolving disputes arising under Section 10(b) or RICO are laid to rest by the history of *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Inc.*, No. 85-5156 (8th Cir. July 9, 1986). There, following this Court's decision in *Dean Witter Reynolds Inc.* v. *Byrd*, plaintiff's state and common law claims were referred to arbitration. That arbitration was concluded in September, 1985, with an award in favor of plaintiff in the amount of $1,500,000. The award was confirmed by judgment of the district court and has been paid. Had plaintiff's claims under Section 10(b) and RICO—based on the same facts as the state and common law claims—been referred to arbitration, those claims too would now have been resolved. As it stands, the district court declined to refer those claims to arbitration and was reversed by the Eighth Circuit. Plainly, the arbitrators in *Phillips* were well able to resolve the factual dispute presented to them.

Finally, the excessive caseload in the federal district courts makes it all the more important that arbitrable claims between securities firms and their customers proceed to arbitration. Filings of securities and commodities claims have steadily increased, reaching 3266 in 1985.[17] Filings of RICO civil actions have risen as well, from 42 in November, 1985, to 99 in April, 1986.[18] Referring Section 10(b) and RICO claims to arbitration will simultaneously expedite resolution of those disputes and help relieve the federal courts of their overloaded dockets, allowing those claims remaining in federal court to be adjudicated more speedily.

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17 Annual Report of the Director of the Administrative Office of the United States Courts, Table 19 (1985). These figures are calculated on the basis of a year beginning July 1. "1985" statistics therefore refer to the period July 1, 1984, through June 30, 1985. A copy of Table 19 is annexed hereto as Appendix B.

18 Communication from the Administrative Office of the United States Courts, Statistical Analysis and Reports Division.

POINT II

THE SECOND CIRCUIT'S OPINION ON RICO IGNORED THE STANDARD FOR FINDING AN IMPLIED REPEAL OF THE UNITED STATES ARBITRATION ACT

By holding that RICO claims are not arbitrable on the basis of its own conception of public policy, the Second Circuit usurped Congress's role in setting federal policy. In so doing, the Second Circuit ignored the express directives of this Court in prior rulings, in particular *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*. *Mitsubishi* requires that any finding of an implied repeal of the Arbitration Act be supported by "congressional intention expressed in some other statute . . . ." 105 S. Ct. at 3355. This is simply a reiteration of the traditional standard for finding that a federal statute has been repealed by implication by a subsequently enacted federal statute. *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. at 88 (" 'repeals by implication [of a prior statute by a subsequently enacted one] are disfavored' ") (quoting *Allen* v. *McCurry*, 449 U.S. 90, 99 (1980)); *Morton* v. *Mancari*, 417 U.S. at 550 ("In the absence of some affirmative showing of an intention [by Congress] to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable").

In *Mitsubishi*, this Court stated:

> We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history.

105 S. Ct. at 3355. Under this test, there can be no question that predispute agreements to arbitrate RICO claims are enforceable under the Arbitration Act. RICO contains no statutory language that restricts a party's ability to choose an arbitral forum with respect to RICO claims. Nor is there any evidence in the legislative history of RICO that Congress

intended to repeal the Arbitration Act with respect to RICO claims. Absent such evidence, the Arbitration Act must apply to RICO claims and agreements to arbitrate those claims must be honored as ordinary contracts.

The Second Circuit did not pretend to apply the *Mitsubishi* test. It cited no statutory text or legislative history to support a repeal of the Arbitration Act. Instead, it based its holding on "the inappropriateness of the United States Arbitration Act when strong public policy considerations"—never identified further—"are involved". 788 F.2d at 98.[19] It made no attempt to balance these "strong public policy considerations" with the express congressional policies embodied in the Arbitration Act, policies that this Court has often recognized. *E.g.*, *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, 105 S. Ct. at 3354; *Southland Corp.* v. *Keating*, 465 U.S. at 10; *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. at 24-25; *Scherk* v. *Alberto-Culver Corp.*, 417 U.S. at 510-11. Far from finding a statutory or legislative basis for an implied repeal of the Arbitration Act with respect to RICO claims, the Second Circuit substituted its own policy judgment for the congressional policy embodied in the Arbitration Act.

Under the *Mitsubishi* test, there can be no implied repeal of the Arbitration Act for RICO claims. The judgment below should be reversed.

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19 The Second Circuit's attempt to apply to RICO its antitrust decision in *American Safety Equipment Corp.* v. *J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) (holding that antitrust law claims are not subject to predispute arbitration agreements), ignores the "skepticism" this Court expressed about *American Safety* in *Mitsubishi*. 105 S. Ct. at 3357. The Court's criticism of *American Safety* in *Mitsubishi* precludes its application to RICO claims. The only *American Safety* consideration that this Court recognized as valid was "the fundamental importance to American democratic capitalism of the regime of the antitrust laws." *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, 105 S. Ct. at 3358. That consideration has no parallel in RICO, especially in its civil aspect, which, as this Court has noted, "is evolving into something quite different from the original conception of its enactors." *Sedima, S.P.R.L.* v. *Imrex Co.*, ___ U.S. ___, 105 S. Ct. 3275, 3287 (1985).

POINT III

THE SECOND CIRCUIT FAILED TO REEXAMINE ITS EXTENSION OF *WILKO* v. *SWAN* TO CLAIMS ARISING UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934 IN LIGHT OF THIS COURT'S OPINIONS IN *SCHERK* v. *ALBERTO-CULVER CO.*, *DEAN WITTER REYNOLDS INC.* v. *BYRD*, AND *MITSUBISHI MOTORS CORP.* v. *SOLER CHRYSLER-PLYMOUTH*

As with its RICO holding, the Second Circuit extended the rule of *Wilko* v. *Swan* to cover Section 10(b) claims without the requisite showing under *Mitsubishi* that Congress intended to repeal the Arbitration Act with respect to such claims. *Wilko* ruled that a party asserting a claim under Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (the "Securities Act"), could not be compelled to submit his claim to arbitration pursuant to a predispute arbitration agreement because Section 14 of the Securities Act, 15 U.S.C. § 77n, which voids any agreement to waive compliance with that Act, repealed the Arbitration Act by implication with respect to Section 12(2) claims. The Court expressed concern that arbitrators would be unfamiliar with the "special right" expressly created by Section 12(2), a right that differed significantly from a traditional action for common law fraud. It further observed that Section 22 of the Securities Act, 15 U.S.C. § 77v, confers jurisdiction on all courts, federal and state, to hear Securities Act claims.

Yet, as Justice White observed in his concurring opinion in *Byrd*, the reasoning of *Wilko* "cannot be mechanically transplanted to" Section 10(b) claims, and *Wilko*'s applicability to Section 10(b) claims "is a matter of substantial doubt." 105 S. Ct. at 1244. Although the Exchange Act contains a non-waiver provision similar to Section 14 of the Securities Act, its applicability to an implied cause of action under Section 10(b), as opposed to an express private right of action like Section 12(2), is far from clear. Unlike the "special right" under

Section 12(2), a Section 10(b) claim closely resembles a traditional common law fraud action. *Dean Witter Reynolds Inc.* v. *Byrd*, ____ U.S. ____, 105 S. Ct. 1238, 1244 (1985) (White, J., concurring).

Moreover, the *Wilko* decision expressed a deep suspicion of the arbitral system as being unable to enforce the Section 12(2) "special rights." Since "we are well past [such] judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals," *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, 105 S. Ct. at 3354, there is no reason to extend *Wilko* to the Exchange Act, much less to the implied cause of action under Section 10(b).

The Second Circuit, in its decision below, ignored the fundamental differences between Section 10(b) and Section 12(2) that this Court identified in *Byrd* and *Scherk*. The court also failed to scrutinize the legislative history of Section 10(b) and RICO for evidence supporting a congressional intent to repeal the Arbitration Act as *Mitsubishi*, *Morton* v. *Mancari*, and *Kaiser Steel Corp.* v. *Mullins* command. It paid no heed to the substantive policies underlying the Arbitration Act that were expressed in *Mitsubishi*, *Moses H. Cone*, and *Southland*. Instead it relied upon a generalized policy argument of its own making, that "[t]he securities laws generally, and the implied causes of action which the Courts have recognized, are designed to protect the public." 788 F.2d at 98. Once again, the Second Circuit failed to analyze the issue as framed by this Court. Instead of searching for congressional intent to repeal the Arbitration Act, it imposed its own policy judgments on the congressionally enacted Arbitration Act.

Although it recognized that this Court has twice stated that the applicability of the Arbitration Act to the implied private right of action under Section 10(b) is an open question, *Dean Witter Reynolds Inc.* v. *Byrd*, 105 S. Ct. at 1240 n.1, 1244 (White, J., concurring), and *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 506, the Second Circuit refused to examine that issue anew in light of this Court's recent decisions concerning the Arbitration Act:

> Although *Scherk* and *Byrd* may cast some doubt on whether the Supreme Court, if presented with the issue, would hold claims under § 10(b) and Rule 10b-5 to be non-arbitrable, it would be improvident for us to disregard clear judicial precedent in this Circuit based on mere speculation. We think that the orderly administration of justice will be best served if we as one of the inferior courts follow Supreme Court precedent and adhere to the settled law of this Circuit . . . .

788 F.2d at 98. In other words, rather than reassessing its prior decisions in light of *Scherk*, *Byrd*, and *Mitsubishi*, the Second Circuit blindly adhered to its own earlier authority and invited this Court to review the case if it saw fit.[20]

POINT IV

THE CIRCUITS STAND IN CONFLICT AS TO THE ARBITRABILITY OF CLAIMS ARISING UNDER SECTION 10(b) AND RICO

A direct conflict now exists among the Circuits with respect to whether a predispute agreement to arbitrate claims arising under Section 10(b) and RICO is enforceable. On July 9, 1986, the Eighth Circuit, following this Court's analysis in *Mitsubishi* and *Southland*, held that the Arbitration Act required enforcement of a predispute agreement to arbitrate where plaintiff alleged violations of Section 10(b) and RICO. *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, No. 85-5156 (8th Cir. July 9, 1986).

As the Eighth Circuit noted, its decision directly conflicts with the decision of the Second Circuit below and that of the Eleventh Circuit in *Miller* v. *Drexel Burnham Lambert, Inc.*, No. 85-5692 (11th Cir. June 17, 1986). Subsequently, the Ninth

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20 That the applicability of *Wilko* to Section 10(b) claims was "the settled law of [the Second] Circuit" is not entirely clear. *Cf. AVC Nederland B.V.* v. *Atrium Inv. Partnership*, 740 F.2d at 157.

Circuit followed the Second and Eleventh Circuits in *Conover* v. *Dean Witter Reynolds, Inc.*, No. 85-6082 (9th Cir. July 17, 1986). That conflict can only be resolved by this Court. A failure to reach a prompt resolution of the issue will only result in uneven enforcement of the Arbitration Act and will unnecessarily clog the lower federal courts with numerous cases that should be arbitrated.

CONCLUSION

For the reasons set forth above, *amici* the Securities Industry Association, Inc., A. G. Edwards & Sons, Inc., Advest, Inc., Alex. Brown & Sons Incorporated, Bateman Eichler, Hill Richards Incorporated, The Chicago Corporation, Dean Witter Reynolds, Inc., Dominick & Dominick, Incorporated, Goldman, Sachs & Co., Howard, Weil, Labouisse, Friedrichs Inc., J. C. Bradford & Co., Johnston, Lemon & Co. Incorporated, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Moseley Securities Corporation, Nomura Securities International, Inc., Piper, Jaffray & Hopwood Incorporated, Prescott, Ball & Turben, Inc., Rauscher Pierce Refsnes, Inc., Raymond, James & Associates, Inc., and Wheat, First Securities, Inc., respectfully request that the petition for a writ of *certiorari* be granted.

Dated: August 12, 1986

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APPENDICES

APPENDIX A

TEXT OF UNIFORM CODE OF ARBITRATION AS ADOPTED BY THE PARTICIPATING ORGANIZATIONS

SECURITIES INDUSTRY ON ARBITRATION CONFERENCE

Reprinted in Fifth Report of the
Securities Industry Conference on Arbitration
(April 1986)
(Exhibit C)

SECTION 1. ARBITRATION

(a) Any dispute, claim or controversy between a (customer or non-member) and a (member, allied member, member organization and/or associated person) arising in connection with the business of such (member, allied member, member organization and/or associated person) in connection with his activities as an associated person shall be arbitrated under the Constitution and Rules of the (name of self-regulatory organization) as provided by any duly executed and enforceable written agreement or upon the demand of the customer or non-member.

(b) Under this Code, the (name of self-regulatory organization) shall have the right to decline the use of its arbitration facilities in any dispute, claim or controversy, where—having due regard for the purposes of the (name of self-regulatory organization) and the intent of this Code—such dispute, claim or controversy is not a proper subject matter for arbitration.

SECTION 2. SIMPLIFIED ARBITRATION

(a) Any dispute, claim or controversy, arising between a public customer(s) and an associated person or a

member subject to arbitration under this Code involving a dollar amount not exceeding $5,000, exclusive of attendant costs and interest, shall, upon demand of the customer(s) or by written consent of the parties, be arbitrated as hereinafter provided.

(b) The claimant shall file with the Director of Arbitration one (1) executed Submission Agreement and one (1) copy of the Statement of Claim of the controversy in dispute, together with documents in support of the claim. The Statement of Claim shall specify the relevant facts, the remedies sought and whether or not a hearing is demanded.

(c) The Claimant shall pay the sum of $15.00 if the amount in controversy is $1,000 or less, $25 if the amount in controversy is more than $1,000 but does not exceed $2,500, or $100 if the amount in controversy is more than $2,500, but does not exceed $5,000 upon filing of the Submission Agreement. The final disposition of this sum shall be determined by the arbitrator.

(d) The Director of Arbitration shall endeavor to serve promptly, by mail or otherwise, on the Respondent(s) one (1) copy of the Submission Agreement and one (1) copy of the Statement of Claim. The Respondent(s) shall, within twenty (20) calendar days from receipt of service, file with the Director of Arbitration one (1) executed Submission Agreement and one (1) copy of the Respondent's answer, together with supporting documents. The Answer shall designate all available defenses to the claim and may set forth any related counterclaim and/or related Third Party Claim the Respondent(s) may have against the Claimant or any other person. If the Respondent(s) has interposed a Third Party Claim, the Director of Arbitration shall endeavor to serve promptly by mail or otherwise a copy of the same, together with a copy of the Submission Agreement

on such Third Party, who shall respond in the manner herein provided for response to the Claim. If the Respondent(s) files a related counterclaim exceeding $5,000, the arbitrator may refer the claim, counterclaim and/or Third Party Claim, if any, to a panel of three (3) or five (5) arbitrators in accordance with Section 19 of this Code, or, may dismiss the Counterclaim and/or Third Party Claim, without prejudice to the Counterclaimant(s) and/or Third Party Claimant(s) pursuing the Counterclaim and/or Third Party Claim in a separate proceeding.

(e) The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the Claimant a copy of the Answer, Counterclaim, Third Party Claim or other responsive pleading, if any. The Claimant, if a Counterclaim is asserted against him, shall within ten (10) calendar days either (i) file a Reply to any Counterclaim with the Director of Arbitration who will serve a copy of the Reply on the Respondent(s) or, (ii) if the amount of the Counterclaim exceeds the Claim, shall have the right to file a statement withdrawing the Claim. If the Claimant withdraws the Claim, the proceedings will be discontinued without prejudice to the rights of the parties.

(f) The dispute, claim or controversy shall be submitted to a single arbitrator knowledgeable in the securities industry selected by the Director of Arbitration. Unless the public customer demands or consents to a hearing, or the arbitrator calls a hearing, the arbitrator shall decide the dispute, claim or controversy solely upon the pleadings and evidence filed by the parties. If a hearing is necessary, such hearing shall be held as soon as practicable at a locale selected by the Director of Arbitration.

(g) The Director of Arbitration may grant extensions of time to file any pleading upon a showing of good cause.

(h) The arbitrator shall be authorized to require the submission of further documentary evidence as he, in his sole discretion, deems advisable.

(i) Upon the request of the arbitrator, the Director of Arbitration shall appoint two (2) additional arbitrators to the panel which shall decide the matter in controversy.

(j) In any case where there is more than one (1) arbitrator, the majority will be public arbitrators.

(k) In his discretion, the arbitrator may, at the request of any party, permit such party to submit additional documentation relating to the pleadings.

(l) Except as otherwise provided herein, the general arbitration rules of the (name of self-regulatory organization) shall be applicable to proceedings instituted under this Code.

SECTION 3. HEARING REQUIREMENTS—WAIVER OF HEARING

(a) Any dispute, claim or controversy, except as provided in Section 2 (Simplified Arbitration), shall require a hearing unless all parties waive such hearing in writing and request that the matter be resolved solely upon the pleadings and documentary evidence.

(b) Notwithstanding a written waiver of a hearing by the parties, a majority of the arbitrators may call for and conduct a hearing. In addition, any arbitrator may request the submission of further evidence.

SECTION 4. TIME LIMITATION UPON SUBMISSION

No dispute, claim or controversy shall be eligible for submission to arbitration under this Code where six (6) years shall have elapsed from the occurrence or event giving rise to the act or the dispute, claim or controversy. This section shall not

extend applicable statutes of limitation, nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction.

SECTION 5. DISMISSAL OF PROCEEDINGS

At any time during the course of an arbitration, the arbitrators may, either upon their own initiative or at the request of a party, dismiss the proceeding and refer the parties to the remedies provided by law. The arbitrators shall, upon the joint request of the parties, dismiss the proceedings.

SECTION 6. SETTLEMENTS

All settlements upon any matter submitted shall be at the election of the parties.

SECTION 7. TOLLING OF TIME LIMITATION(S) FOR THE INSTITUTION OF LEGAL PROCEEDINGS AND EXTENSION OF TIME LIMITATION(S) FOR SUBMISSION OF ARBITRATION

(a) Where permitted by law, the time limitation(s) which would otherwise run or accrue for the institution of legal proceedings shall be tolled when a duly executed Submission Agreement is filed by the Claimant(s). The tolling shall continue for such period as the (name of self-regulatory organization) shall retain jurisdiction upon the matter submitted.

(b) The six (6) year time limitation upon submission to arbitration shall not apply when the parties have submitted the dispute, claim or controversy to a court of competent jurisdiction. The six (6) year time limitation shall not run for such period as the court shall retain jurisdiction upon the matter submitted.

SECTION 8. DESIGNATION OF THE NUMBER OF ARBITRATORS

(a) Public Controversies

(1) Except as otherwise provided in this Code, in all arbitration matters involving public customers, and where the matter in controversy does not exceed the amount of $500,000, or where the matter in controversy does not involve or disclose a money claim, the Director of Arbitration shall appoint an arbitration panel which shall consist of no less than three (3) nor more than five (5) arbitrators, at least a majority of whom shall not be from the securities industry, unless the public customer requests a panel consisting of at least a majority from the securities industry.

(2) In all arbitration matters involving public customers where the amount in controversy is $500,000 or more, the Director of Arbitration shall appoint an arbitration panel which shall consist of five (5) arbitrators, unless the parties agree in writing to a panel of three (3) arbitrators, at least a majority of whom shall not be from the securities industry, unless the public customer requests a panel consisting of at least a majority from the securities industry.

(b) Composition of Panels

The individuals who serve on a particular arbitration panel shall be determined by the Director of Arbitration. The Director of Arbitration may name the chairman of each panel.

SECTION 9. NOTICE OF SELECTION OF ARBITRATORS

The Director of Arbitration shall inform the parties of the names and business affiliations of the arbitrators at least eight (8) business days prior to the date fixed for the initial hearing session.

SECTION 10. CHALLENGES

In any arbitration proceeding, each party shall have the right to one peremptory challenge. In arbitrations where there are multiple Claimants, Respondents and/or Third Party Respondents, the Claimants shall have one peremptory challenge, the Respondents shall have one peremptory challenge and the Third Party Respondents shall have one peremptory challenge, unless the Director of Arbitration determines that the interests of justice would best be served by awarding additional peremptory challenges. Unless extended by the Director of Arbitration, a party wishing to exercise a peremptory challenge must do so by notifying the Director of Arbitration in writing within five (5) business days of notification of the identity of the persons named to the panel. There shall be unlimited challenges for cause.

SECTION 11. DISCLOSURES REQUIRED OF ARBITRATORS

Each arbitrator shall be required to disclose to the Director of Arbitration any circumstances which might preclude such arbitrator from rendering an objective and impartial determination. Prior to the commencement of the first hearing session, the Director of Arbitration may remove an arbitrator who discloses such information. The Director of Arbitration shall also inform the parties of any information disclosed pursuant to this section if the arbitrator who disclosed information is not removed.

SECTION 12. DISQUALIFICATION OR OTHER DISABILITY OF ARBITRATORS

In the event that any arbitrator, after the commencement of the first session but prior to the rendition of the award, should become disqualified, resign, die, refuse or be unable to perform or discharge his duties, the Director of Arbitration, upon such proof as he deems satisfactory, shall, where permitted by law, either: (a) appoint a new member to the panel to replace

such arbitrator, obtaining the consent of the parties; or (b) with the consent or waiver of the parties, direct that the arbitration proceed without the substitution of a new arbitrator.

SECTION 13. INITIATION OF PROCEEDINGS

Except as otherwise provided herein, an arbitration proceeding under this Code shall be instituted as follows:

(a) Statement of Claim

The Claimant shall file with the Director of Arbitration three (3) executed copies of the Submission Agreement and three (3) copies of the Statement of Claim of the controversy in dispute, together with the documents in support of the claim. The Statement of Claim should specify the relevant facts and the remedies sought. The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the Respondent(s) one (1) copy of the Submission Agreement and one (1) copy of the Statement of Claim.

(b) Answers—Defenses, Counterclaims and/or Cross-claims

(1) The Respondent(s) shall within twenty (20) business days from receipt of service file with the Director of Arbitration one (1) executed Submission Agreement and one (1) copy of the Respondent's(s') Answer. The Answer shall specify all available defenses and relevant facts that will be relied upon at the hearing and may set forth any related Counterclaim the Respondent(s) may have against the Claimant and any Third Party Claim against any other party or person upon any existing dispute, claim or controversy to arbitration under this Code.

(2) (i) Respondent, Responding Claimant, Cross-Claimant or Third Party Respondent who pleads only a general denial as an answer may, upon written objection by the adversary party

before the hearing to the Director of Arbitration, in the discretion of the arbitrators, be barred from presenting any facts or defenses at the time of the hearing.

(ii) A Respondent, Responding Claimant, Cross-Claimant or Third Party Respondent who fails to specify all available defenses and relevant facts in such party's answer may, upon objection by the adversary party, in the discretion of the arbitrators, be barred from presenting the facts or defenses not included in such party's answer at the hearing.

(iii) A Respondent, Responding Claimant, Cross-Claimant or Third Party Respondent who fails to file an answer within twenty (20) business days from receipt of service, or unless the time to answer has been extended pursuant to paragraph (5), may, in the discretion of the arbitrators, be barred from presenting any matter, arguments or defenses at the hearing.

(3) If the Respondent(s) has interposed a Third Party Claim, the Director of Arbitration shall endeavor to serve promptly by mail or otherwise a copy of the same together with a copy of the Submission Agreement on such Third Party, who shall respond in the manner provided for response to the Claim.

(4) The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the claimant a copy of the Answer, Counterclaim, Third Party Claim or other responsive pleading, if any. The Claimant may within ten (10) business days file a Reply to the Counterclaim with the Director of Arbitration, who will serve a copy of the Reply on the Respondent(s).

(5) The time period to file any pleading, whether such be denominated as a Claim, Answer, Counterclaim, Reply or Third Party Pleading, may be extended for such further periods as may be granted by the Director of Arbitration.

(c) Joining and Consolidation

(1) With respect to any dispute, claim or controversy submitted to arbitration, any party or person eligible to submit a claim under this Code shall have the right to proceed in the same arbitration against any other party or person upon any claim directly related to such dispute.

(2) For purposes of this subsection, the Director of Arbitration shall be authorized to determine preliminarily whether a claim is directly related to the matter in dispute and to join any other party to the dispute and to consolidate the matter for hearing and award purposes. In arbitrations where there are multiple Claimants, Respondents and/or Third Party Respondents, the Director of Arbitration shall be authorized to determine preliminarily whether such parties should proceed in the same or separate arbitrations.

(3) All final determinations with respect to joining, consolidation and multiple parties under this subsection shall be made by the arbitration panel.

SECTION 14. DESIGNATION OF TIME AND PLACE OF HEARINGS

Unless the law directs otherwise, the time and place for the initial hearing shall be determined by the Director of Arbitration and each hearing thereafter by the arbitrators. Notice of the time and place for the initial hearing shall be given at least eight (8) business days prior to the date fixed for the hearing by

personal service, registered or certified mail to each of the parties unless the parties shall, by their mutual consent, waive the notice provisions under this section. Notice for each hearing, thereafter, shall be given as the arbitrators may determine. Attendance at a hearing waives notice thereof.

SECTION 15. REPRESENTATION BY COUNSEL

All parties shall have the right to representation by counsel at any stage of the proceedings.

SECTION 16. ATTENDANCE AT HEARINGS

The attendance or presence of all persons at hearings, including witnesses, shall be determined by the arbitrators. However, all parties to the arbitration and their counsel shall be entitled to attend all hearings.

SECTION 17. FAILURE TO APPEAR

If any of the parties, after due notice, fails to appear at a hearing or any adjourned hearing session, the arbitrators may, in their discretion, proceed with the arbitration of the controversy. In such cases, all awards shall be rendered as if each party had entered an appearance in the matter submitted.

SECTION 18. ADJOURNMENTS

(a) The arbitrators may, in their discretion, adjourn any hearing(s) either upon their own initiative or upon the request of any party to the arbitration.

(b) A party requesting an adjournment after arbitrators have been appointed, if said adjournment is granted, shall pay a fee equal to the deposit of costs but not more than $100. The arbitrators may waive this fee or in their awards may direct the return of this adjournment fee. This provision shall not apply to matters filed under Section 2 of the Code.

SECTION 19. ACKNOWLEDGMENT OF PLEADINGS

The arbitrators shall acknowledge to all parties present that they have read the pleadings filed by the parties.

SECTION 20. SUBPOENA PROCESS

(a) The arbitrators and any counsel of record to the proceedings shall have the power of the subpoena process as provided by law. However, the parties shall produce witnesses and present proofs to the fullest extent possible without resort to the issuance of the subpoena process.

(b) Prior to the first hearing session, the parties shall cooperate in the voluntary exchange of such documents and information as will serve to expedite the arbitration. If the parties agree, they may also submit additional documents to the Director of Arbitration for forwarding to the arbitrators.

SECTION 21. POWER TO DIRECT APPEARANCES

The arbitrators shall be empowered without resort to the subpoena process to direct the appearance of any person employed or associated with any member or member organization of the (name of self-regulatory organization) and/or the production of any records in the possession or control of such persons, members or member organizations. Unless the arbitrators direct otherwise, the party requesting the appearance of a person or the production of documents under this section shall bear all reasonable costs of such appearance and/or production.

SECTION 22. EVIDENCE

The arbitrators shall determine the materiality and relevance of any evidence proffered and shall not be bound by rules governing the admissibility of evidence.

SECTION 23. INTERPRETATION OF THE CODE

The arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code of which interpretation shall be final and binding upon the parties.

SECTION 24. DETERMINATIONS OF ARBITRATORS

All rulings and determinations of the panel shall be a majority of the arbitrators.

SECTION 25. RECORD OF PROCEEDINGS

Unless requested by the arbitrators or a party or parties to a dispute, no record of an arbitration proceeding shall be kept. If the record is kept, it shall be a verbatim record. If a party or parties to a dispute elect to have the record transcribed, the cost of such transcription shall be borne by the party or parties making the request.

SECTION 26. OATHS OF THE ARBITRATORS AND WITNESSES

Prior to the commencement of the first session, an oath or affirmation shall be administered to the arbitrator(s). All testimony shall be under oath or affirmation.

SECTION 27. AMENDMENTS

(a) After the filing of any pleadings, if a party desires to file anew or different pleading, such change must be made in writing and filed with the Director of Arbitration. The Director of Arbitration shall endeavor to serve promptly by mail or otherwise upon all

parties a copy of said change. The other parties may, within ten (10) business days from the receipt of service, file a response with the Director of Arbitration.

(b) After a panel has been appointed, no new or different pleading may be filed except for a responsive pleading as provided for in (a) above or with the panel's consent.

SECTION 28. REOPENING OF HEARINGS

Where permitted by law, the hearings may be reopened by the arbitrators on their own motion or in the discretion of the arbitrators upon application of party at any time before the award is rendered.

SECTION 29. AWARDS

(a) All awards shall be in writing and signed by a majority of the arbitrators or in such manner as is required by law. Such awards may be entered as a judgment in any court of competent jurisdiction.

(b) Unless the law directs otherwise, all awards rendered pursuant to this Code shall be deemed final and not subject to review or appeal.

(c) The Director of Arbitration shall endeavor to serve a copy of the award: (i) by registered or certified mail upon all parties, or their counsel, at the address of record; or, (ii) by personally serving the award upon the parties; or, (iii) by filing or delivering the award in such a manner as may be authorized by law.

(d) The arbitrator(s) shall endeavor to render an award within thirty (30) business days from the date the record is closed.

SECTION 30. MISCELLANEOUS

This Code shall be deemed a part of and incorporated by reference in every duly-executed Submission Agreement which shall be binding on all parties.

SECTION 31. SCHEDULE OF FEES

(a) At the time of filing a Submission Agreement, a Claimant shall deposit with the (name of self-regulatory organization) the amount indicated below unless such deposit is specifically waived by the Director of Arbitration.

Amount in Dispute (Exclusive of interest and expenses)	*Amount of Deposit*
$1,000 or less	$15
Above $1,000 but not exceeding $2,500	$25
Above $2,500 but not exceeding $5,000	$100
Above $5,000 but not exceeding $10,000	$200
Above $10,000 but not exceeding $50,000	$400
Above $50,000 but not exceeding $100,000	$500
Above $100,000 but not exceeding $500,000	$750
Above $500,000	$1,000

Where the amount in dispute is $10,000 or less, no additional deposits shall be required despite the number of sessions. Where the amount in dispute is above $10,000 and multiple sessions are required, the arbitrators may require any of the parties to make additional deposits for each additional session. In no event shall the aggregate amount deposited per session exceed the amount of the initial deposit as set forth in the above schedule.

(b) The arbitrators, in their awards, may determine the amount chargeable to the parties as forum fees (fees) and shall determine by whom such fees shall be borne. Where the amount in dispute is $10,000 or less, total fees to the parties shall not exceed the amount deposited. Where the amount in dispute is above $10,000 but does not exceed $50,000, the

maximum fee shall be $300 per session. Where the amount in dispute is above $50,000 but does not exceed $100,000, the maximum fee shall be $500 per session. Where the amount in dispute is above $100,000 but does not exceed $500,000, the maximum fee shall be $750 per session. Where the amount in dispute is above $500,000, the maximum fee shall be $1,000 per session. Amounts deposited by a party shall be applied against fees, if any. If the fees are not assessed against a party who had made a deposit, the deposit will be refunded.

(c) If the dispute, claim or controversy does not involve or disclose a money claim, the amount to be deposited by the claimant shall be $100, or such amount as the Director of Arbitration or the panel of arbitrators may require, but shall not exceed $1,000.

(d) Any matter submitted and thereafter settled or withdrawn prior to the commencement of the first session shall entitle the parties to a refund of all but $25 of the amount deposited with the (name of self-regulatory organization).

(e) Any matter submitted and thereafter settled or withdrawn subsequent to the commencement of the first session may be subject to such refund of assessed deposits, if any, as the (name of self-regulatory organization) may determine.

(f) The arbitrators may assess forum fees and Section 21 costs in any matter settled or withdrawn subsequent to the commencement of the first session.

APPENDIX B

Fifth Report of the Securities Industry Conference on Arbitration Statistical Report (April 1986) (Exhibit A)

COMPOSITE ARBITRATION FIGURES

	Total Cases Received	*Total Cases Concluded, Including Settlements*	*Small Claims Received*	*Small Claims Concluded*	*Public Customer Cases Decided*	*Awards in Favor of Public*
1980	830	686	332	269	410	205
1981	1,042	980	306	357	532	264
1982	1,340	1,044	322	292	558	293
1983	1,731	1,259	416	320	622	331
1984	2,449	1,762	561	489	736	366
1985	2,796	2,190	664	520	961	530

AMERICAN STOCK EXCHANGE, INC.

	Total Cases Received	*Total Cases Concluded, Including Settlements*	*Small Claims Received*	*Small Claims Concluded*	*Public Customer Cases Decided*	*Awards in Favor of Public*
1980	45	41	18	11	35	16
1981	39	40	7	11	42	22
1982	37	31	9	4	16	10
1983	41	42	14	8	10	6
1984	69	53	16	14	45	26
1985	64	58	21	14	41	24

Cases carried over into 1986: 29

BOSTON STOCK EXCHANGE, INC.

	Total Cases Received	*Total Cases Concluded, Including Settlements*	*Small Claims Received*	*Small Claims Concluded*	*Public Customer Cases Decided*	*Awards in Favor of Public*
1980	2	2	2	2	2	0
1981	2	2	2	2	0	0
1982	1	1	1	1	1	1
1983	2	2	2	2	2	1
1984	0	0	0	0	0	0
1985	0	0	0	0	0	0

Cases carried over into 1986: 0

CHICAGO BOARD OPTIONS EXCHANGE, INC.

	Total Cases Received	*Total Cases Concluded, Including Settlements*	*Small Claims Received*	*Small Claims Concluded*	*Public Customer Cases Decided*	*Awards in Favor of Public*
1980	44	31	11	11	18	6
1981	41	32	8	8	12	3
1982	50	38	6	6	14	3
1983	75	45	5	4	13	6
1984	91	56	24	16	4	3
1985	64	38	10	5	0	0

Cases carried over into 1986: 26

CINCINNATI STOCK EXCHANGE, INC.

	Total Cases Received	*Total Cases Concluded, Including Settlements*	*Small Claims Received*	*Small Claims Concluded*	*Public Customer Cases Decided*	*Awards in Favor of Public*
1980	0	0	0	0	0	0
1981	0	0	0	0	0	0
1982	0	0	0	0	0	0
1983	0	0	0	0	0	0
1984	0	0	0	0	0	0
1985	0	0	0	0	0	0

Cases carried over into 1986: 0

MIDWEST STOCK EXCHANGE, INC.

	Total Cases Received	*Total Cases Concluded, Including Settlements*	*Small Claims Received*	*Small Claims Concluded*	*Public Customer Cases Decided*	*Awards in Favor of Public*
1980	2	2	1	0	1	1
1981	2	2	0	0	0	0
1982	1	0	0	0	0	0
1983	2	2	0	0	0	0
1984	1	0	0	0	0	0
1985	1	0	0	0	0	0

Cases carried over into 1986: 2

MUNICIPAL SECURITIES RULEMAKING BOARD

	Total Cases Received	*Total Cases Concluded, Including Settlements*	*Small Claims Received*	*Small Claims Concluded*	*Public Customer Cases Decided*	*Awards in Favor of Public*
1980	21	21	7	7	3	2
1981	25	25	5	5	7	4
1982	33	30	7	7	13	6
1983	78	39	17	9	14	5
1984	113	77	20	17	34	21
1985	91	112	31	35	54	31

Cases carried over into 1986: 60

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

	Total Cases Received	*Total Cases Concluded, Including Settlements*	*Small Claims Received*	*Small Claims Concluded*	*Public Customer Cases Decided*	*Awards in Favor of Public*
1980	318	234	134	113	122	56
1981	422	422	142	177	242	118
1982	606	435	157	139	276	140
1983	768	549	216	147	272	161
1984	1,108	747	298	244	381	196
1985	1,400	962	377	250	434	232

Cases carried over into 1986: 1,452

NEW YORK STOCK EXCHANGE, INC.

	Total Cases Received	*Total Cases Concluded, Including Settlements*	*Small Claims Received*	*Small Claims Concluded*	*Public Customer Cases Decided*	*Awards in Favor of Public*
1980	367	327	131	110	221	119
1981	477	433	117	134	214	111
1982	558	473	109	113	214	118
1983	713	532	136	122	276	137
1984	1,008	796	176	183	259	113
1985	1,095	962	198	190	424	221

Cases carried over into 1986: 831

PACIFIC STOCK EXCHANGE, INC.

	Total Cases Received	*Total Cases Concluded, Including Settlements*	*Small Claims Received*	*Small Claims Concluded*	*Public Customer Cases Decided*	*Awards in Favor of Public*
1980	24	28	12	11	4	3
1981	24	20	17	17	9	5
1982	31	21	15	11	10	7
1983	35	29	17	17	23	10
1984	45	26	21	11	10	7
1985	50	40	12	18	20	12

Cases carried over into 1986: 54

PHILADELPHIA STOCK EXCHANGE, INC.

	Total Cases Received	*Total Cases Concluded, Including Settlements*	*Small Claims Received*	*Small Claims Concluded*	*Public Customer Cases Decided*	*Awards in Favor of Public*
1980	7	0	16	4	4	2
1981	10	6	6	3	6	1
1982	23	15	18	11	14	8
1983	17	19	9	11	12	5
1984	14	7	6	4	3	0
1985	31	18	15	8	8	2

Cases carried over into 1986: 14

APPENDIX C

Table 19
U.S. District Court
Civil Cases Commenced by Nature of Suit
During the Twelve Month Periods Ended June 30, 1981 through 1985

Nature of Suit	*1981*	*1982*	*1983*	*1984*	*1985*	*Percent Change 1985/ 1984*
Total	180,576	206,193	241,842	261,485	273,670	4.7
Contracts	51,159	67,276	84,017	88,231	102,642	16.3
Insurance	4,234	5,324	6,184	6,211	6,851	10.3
Marine	5,143	5,552	5,721	5,031	5,037	0.1
Miller Act	754	866	1,168	1,283	1,623	26.5
Negotiable Instruments	4,072	3,332	3,987	5,292	4,122	−22.1
Recovery of Overpayments and Enforcement of Judgments	18,161	30,048	41,213	46,190	58,160	25.9
Other	19,535	21,499	24,439	24,756	26,849	8.5
Real Property Actions	8,887	8,812	9,667	9,192	10,118	10.1
Mortgage Foreclosure	4,725	5,754	6,382	6,660	7,465	12.1
Land Condemnation	2,179	1,055	985	508	670	31.9
Other	1,983	2,003	2,300	2,024	1,983	−2.0
Tort Actions	33,767	34,218	36,484	37,522	41,593	10.8

Nature of Suit	*1981*	*1982*	*1983*	*1984*	*1985*	*Percent Change 1985/ 1984*
Employers' Liability Act	1,876	2,017	2,102	1,914	2,221	16.0
Airplane	545	589	792	748	613	−18.0
Marine	5,166	5,272	4,829	4,455	4,367	−2.0
Motor Vehicle	5,708	6,095	6,413	6,502	6,776	4.2
Other Personal Injury	7,997	8,253	9,990	10,177	11,076	8.8
Personal Injury Product Liability	8,028	7,908	8,026	9,677	12,507	29.2
Property Damage	4,447	4,084	4,332	4,049	4,033	−0.4
Actions Under Statutes	86,172	95,294	111,100	125,953	118,833	−5.7
Antitrust	1,352	1,066	1,213	1,124	1,082	−3.7
Bankruptcy Suits	1,985	2,340	3,775	4,645	6,331	36.3
Civil Rights:						
Accommodations	336	237	296	291	253	−13.1
Employment	6,245	7,689	9,097	9,748	8,082	−17.1
Voting	152	170	175	259	281	8.5
Welfare	253	215	229	183	180	−1.6
Other Civil Rights	8,433	8,727	9,938	10,738	10,757	0.2
Commerce (ICC rates, etc.)	1,080	1,057	1,043	1,000	912	−8.8
Deportation	113	134	141	193	185	−4.1
Economic Stabilization Act	47	27	42	24	22	−8.3
Energy Allocation Act	104	47	35	41	34	−17.1

Nature of Suit	*1981*	*1982*	*1983*	*1984*	*1985*	*Percent Change 1985/ 1984*
Environmental Matters	582	394	465	671	652	−2.8
Forfeiture and Penalty Suits	2,963	3,340	3,463	3,708	4,908	32.4
Freedom of Information Act	507	381	454	479	565	18.0
Labor Laws	9,300	10,227	11,033	11,821	11,749	−0.6
Patent, Copyright, Trademark	4,027	4,592	5,413	5,298	5,412	2.2
Prisoner Petitions:						
Federal	4,104	4,328	4,354	4,526	6,262	38.4
State	23,607	24,975	26,421	26,581	27,206	2.4
Securities, Commodities and Exchange	1,768	2,376	2,915	3,142	3,266	3.9
Social Security Laws	9,780	12,812	20,315	29,985	19,771	−34.1
Tax Suits	3,930	4,234	4,187	3,862	3,006	−22.2
Other	5,504	5,926	6,096	7,634	7,917	3.7
Other Actions	591	593	574	587	484	−17.5
Domestic Relations (Local Jurisdiction	12	5	5	—	5	—
Insanity (Local Jurisdiction)	135	113	162	94	—	—
Other	444	475	407	493	479	−2.8

No. 86-44

Supreme Court, U.S.
FILED
NOV 20 1986
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

JOINT APPENDIX

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Petition For Certiorari Filed July 14, 1986
Petition For Certiorari Granted October 6, 1986

TABLE OF CONTENTS

Page

General Docket
United States Court of Appeals for the Second Circuit i

The Following Have Already Been Reprinted in the Appendix to the Petition for a Writ of Certiorari at the Pages Indicated:

A. Statutory and Regulatory Provisions Involved A-1

B. Opinion of the United States Court of Appeals for the Second Circuit A-6

C. Opinion of the United States District Court for the Southern District of New York A-19

D. Judgment of the United States Court of Appeals for the Second Circuit, Entered on April 16, 1986 ..... A-30

E. District Court Cases Addressing the Enforceability of Agreements to Arbitrate § 10(b) Claims A-32

F. District Court Cases Addressing the Enforceability of Agreements to Arbitrate Civil RICO Claims A-43

GENERAL DOCKET

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

DATE	FILINGS - PROCEEDINGS	85-7844
10-28-85	Copy of district court docket entries and notice of appeal on behalf of the appellants EUGENE & JULIA MCMAHON, filed (85-7844)	
10-28-85	Copy of district court docket entries and notice of cross-appeal on behalf of the cross-appellant SHEARSON/AMERICAN EXPRESS, INC. filed (85-7846)	
10-30-85	Copy of receipt re: Payment of docketing fee in district court filed (85-7846)	
11-4-85	Appellants EUGENE & JULIA MCMAHON, Form C filed (w/pfs/copy of order) (85-7844)	
11-4-85	Appellants EUGENE & JULIA MCMAHON, Form D filed (w/pfs) (85-7844)	
11-5-85	Cross-Appellants SHEARSON/AMERICAN EXPRESS, INC., Form C filed (w/pfs) (85-7846)	
11-5-85	Cross-Appellants SHEARSON/AMERICAN EXPRESS, INC., Form D filed (w/pfs) (85-7846)	
11-7-85	Copy of receipt re: Payment of docketing fee in district court filed (85-7844)	
11-13-85	Scheduling order #1, PC filed (85-7844 & 85-7846)	
12-4-85	Scheduling order #2 filed	
12-19-85	Record on appeal filed (original papers of district court)	

DATE	FILINGS - PROCEEDINGS
12-30-85	Appellant-Cross-Appellee MCMAHON brief filed (w/pfs)
12-30-85	Appellant-Cross-Appellee MCMAHON joint appendix filed (w/pfs)
1-21-86	Appellee-Cross-Appellant SHEARSON/ AMERICAN EXPRESS INC. AND MARY ANN MCNULTY brief and addendum filed (w/pfs)
1-22-86	Movant (Securities Industry Association) motion for leave to file brief as amicus curiae filed (w/pfs)
2-3-86	Appellants MCMAHON et al reply brief filed (w/pfs)
2-4-86	Order granted Securities Industry Assoc. for leave to file brief as amicus filed (endorsed on motion filed January 22, 1986)
2-4-86	Brief of amicus curiae Securities Industry Assoc. brief filed (w/pfs)
3-3-86	Case heard before Feinberg, Chief Judge, Timbers, Newman, C.JJ.
3-10-86	Appellees-Cross-Appellants SHEARSON/ AMERICAN EXPRESS INC. motion for leave to obtain transcript of oral argument filed (w/pfs)
3-12-86	Order granting appellee SHEARSON/ AMERICAN EXPRESS INC leave to obtain transcript of oral argument the extent that access to the court's recording of the oral argument so that a certified court reporter may transcribe the

DATE	FILINGS - PROCEEDINGS
	recording under the direction of the clerk. IT IS FURTHER ORDERED that until approval of the transcript is advised by the clerk, no copies shall be released by the reporter filed (endorsed on motion filed March 10, 1986)
4-16-86	Judgment Affirmed in part; Reversed and Remanded in part by published signed opinion (WHT)
4-16-86	Judgment filed
4-29-86	Appellees SHEARSON/AMERICAN EXPRESS et al motion for Stay of Mandate Pending appeal to U.S. Supreme Court filed (w/pfs)
4-30-86	Appellants-Cross-Appellees MCMAHON bill of costs *received* (w/pfs)
5-7-86	Appellants MCMAHON et al affidavit in opposition to motion for a stay of the mandate filed (w/pfs)
5-7-86	Appellants MCMAHON et al memorandum of law in opposition to motion for a stay of the mandate filed (w/pfs)
5-8-86	Order Denied appellees SHEARSON/AMERICAN EXPRESS et al motion for stay of mandate pending appeal to U.S. Supreme Court filed (endorsed on motion filed April 29, 1986)
5-9-86	Statement of costs filed
5-12-86	Mandate (opinion, order & statement of costs) issued
7-23-86	Notice of filing of petition for writ of certiorari filed. (S.C.# 86-44)

Supreme Court, U.S.
FILED
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CLERK

No. 86-44

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF OF PETITIONERS

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QUESTIONS PRESENTED

1. Whether the United States Arbitration Act, 9 U.S.C. § 1 *et seq.* (1982), mandates arbitration of claims asserted under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (1982) pursuant to a valid arbitration agreement?

2. Whether the United States Arbitration Act, 9 U.S.C. § 1 *et seq.* (1982), mandates arbitration of claims asserted under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.* (1982) pursuant to a valid arbitration agreement?

RULE 28.1 LIST*

Non-Wholly Owned Subsidiaries and Affiliates of Shearson Lehman Brothers Inc.

Active Subsidiaries

Shearson Lehman/Amex Finanz A.G.
Shearson/NGP Inc.

Affiliates

Banque Eurofin
Barony Company Ltd.
Carnegie Capital Management Company
Russell Energy Inc.

Non-Wholly Owned Subsidiaries and Affiliates of Shearson Lehman Brothers Holdings Inc., the parent company of Shearson Lehman Brothers Inc.**

Dr. Pepper Holding Company
Shearson Lehman Brothers Limited
The McLeod Young Weir Corporation

---

* This list supplements the Rule 28.1 List contained in the Petition for a Writ of Certiorari.

** The parent company of Shearson Lehman Brothers Holdings Inc. is the American Express Company.

TABLE OF CONTENTS

	Page
Questions Presented	i
Rule 28.1 List	ii
Table of Authorities	vi
Opinions Below	1
Jurisdiction	2
Statutory and Regulatory Provisions Involved	2
Statement of the Case	3
Summary of Argument	7
Argument	10
I. The United States Arbitration Act Mandates Enforcement of Contractual Agreements to Arbitrate Statutory Claims Absent Congressional Intent to the Contrary	10
II. Congress Did Not Intend to Create an Exception To the Arbitration Act Prohibiting the Enforcement of Contractual Agreements to Arbitrate Claims Asserting an Implied Right of Action Under § 10(b) of the Exchange Act	14
A. *Wilko v. Swan* Should Not Be Extended to Prohibit Enforcement of Agreements to Arbitrate Claims Asserted Under § 10(b) of the Exchange Act	19
1. Section 10(b) of the Exchange Act does not contain the "special right" granted by Congress to purchasers of securities in § 12(2) of the Securities Act	21

Page

2. The anti-waiver provision in § 29(a) of the Exchange Act does not preclude enforcement of agreements to arbitrate the § 10(b) cause of action which was not expressly created by Congress 24

3. This Court has recognized that the *Wilko* doctrine does not necessarily apply to § 10(b) of the Exchange Act 26

B. Congress Intended an Anti-Waiver Provision To Prohibit Waiver of Substantive Compliance With a Statute and Not to Preclude Enforcement of Statutory Rights in An Arbitral Forum 28

C. The Court of Appeals Erred by Relying on The *Wilko* Court's Misplaced and Outdated Concerns Regarding the Adequacy of Arbitral Forums to Resolve Federal Securities Law Disputes 33

III. Congress Did Not Intend to Preclude Enforcement of Contractual Agreements to Arbitrate Claims Asserted Under RICO 39

A. The Public Policy Rationale Relied on by The Court of Appeals for Prohibiting Arbitration of RICO Claims is Not Supported by the RICO Statute or its Legislative History 41

B. Public Policy Considerations are Nevertheless Misplaced Given the Nature of the Civil RICO Claims Presently Being Asserted in the District Courts 46

Conclusion 50

Page

Appendix

A. Statutory and Regulatory Provisions Involved A-1

TABLE OF AUTHORITIES

	Page
Cases	
Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972)	23
Allegaert v. Perot, 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977)	4, 5, 19
American Safety Equip. Corp. v. J. P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968)	7, 42, 43
Amoco Overseas Oil Co. v. Astir Navigation Co., 490 F. Supp. 32 (S.D.N.Y. 1979)	38
Armstrong v. McAlpin, 699 F.2d 79 (2d Cir. 1983)	36
Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976)	19
Bale v. Dean Witter Reynolds, Inc., 627 F. Supp. 650 (D. Minn. 1986)	47
Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 693 F.2d 1023 (11th Cir. 1982)	12, 19
Blackie v. Barrack, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976)	23
Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)	15, 36
Botany Indus., Inc. v. New York Joint Board, 375 F.Supp. 485 (S.D.N.Y.), *vacated on other grounds sub. nom., Robb v. New York Joint Board*, 506 F.2d 1246 (2d Cir. 1974)	38

Page

Brener v. Becker Paribas Inc., 628 F. Supp. 442 (S.D.N.Y. 1985) 47

Cackett v. Keswick, [1902] 2 Ch. 456 (C.A.) 31

Coenen v. R. W. Pressprich & Co., 453 F.2d 1209 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972) 32

Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520 (9th Cir. 1986) 18, 28

Cunningham v. Dean Witter Reynolds, Inc., 550 F. Supp. 578 (E.D. Cal. 1982) 12

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DeLancie v. Birr, Wilson & Co., 648 F.2d 1255 (9th Cir. 1981) 19

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) .. *passim*

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Girouard v. United States, 328 U.S. 61 (1946) 19

Greenwood v. Leather Shod Wheel Co., [1900] 1 Ch. 42 (C.A.) 31

Haroco, Inc. v. American Nat. Bank and Trust Co., 747 F.2d 384 (7th Cir. 1984), *aff'd*, 105 S. Ct. 3291 (1985) (per curiam) 47

Herman & MacLean v. Huddleston, 459 U.S. 375 (1983) 15

Hirschey v. F.E.R.C., 777 F.2d 1 (D.C. Cir. 1985) . 19

Page

Huss v. Goldman, Sachs & Co., 635 F. Supp. 1227 (N.D. Ill. 1986) 47

Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 797 F.2d 1197 (3d Cir. 1986) 28, 40,41, 46

Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946) 15

Liskey v. Oppenheimer & Co., 717 F.2d 314 (6th Cir. 1983) 13

McMahon v. Shearson/American Express, Inc., 618 F. Supp. 384 (S.D.N.Y. 1985), *aff'd in part, rev'd in part*, 788 F.2d 94 (2d Cir. 1986) 4, 5

McMahon v. Shearson/American Express, Inc., 788 F.2d 94 (2d Cir. 1986) ..... *passim*

Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017 (6th Cir. 1979) 19

Mayaja, Inc. v. Bodkin, 803 F.2d 157 (5th Cir. 1986) ..... *passim*

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 636 F. Supp. 444 (S.D.N.Y. 1986) 38

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore, 590 F.2d 823 (10th Cir. 1978) 19

Miley v. Oppenheimer & Co., 637 F.2d 318 (5th Cir. 1981) 12

Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 105 S. Ct. 3346 (1985) ..... *passim*

Moran v. Paine, Webber, Jackson & Curtis Inc., 389 F.2d 242 (3d Cir. 1968) 18

Page

Morton v. Mancari, 417 U.S. 535 (1974) 16

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983) 12

Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 795 F.2d 1393 (8th Cir. 1986) 19, 28

Radzanower v. Touche Ross & Co., 426 U.S. 148 (1976) 16

Randall v. Loftsgaarden, 106 S. Ct. 3143 (1986) ... 10, 23

Ross v. Mathis, 624 F. Supp. 110 (N.D. Ga. 1985) .. 49

Sacks v. Dean Witter Reynolds Inc., 627 F. Supp. 377 (C.D. Cal. 1985) 48

San Martine Campania de Navegacion v. Saguenay Terminals, Ltd., 293 F.2d 796 (9th Cir. 1961) ... 38

Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974) . 18, 27

Sedima, S.P.R.L. v. Imrex Co., 105 S. Ct. 3275 (1985) 47, 48

Sibley v. Tandy Corp., 543 F.2d 540 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977) 19

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Southland Corp. v. Keating, 465 U.S. 1 (1984) 12

Page

Steinberg v. The Illinois Co., 635 F. Supp. 615 (N.D. Ill. 1986) 48

Superintendent of Insurance v. Bankers Life & Cas. Co., 404 U.S. 6 (1971) 15

Surman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 733 F.2d 59 (8th Cir. 1984) 13, 19

Swift Indus., Inc. v. Botany Indus., Inc., 466 F.2d 1125 (3d Cir. 1972) 38

Tashea v. Bache, Halsey, Stuart, Shields, Inc., 802 F.2d 1337 (11th Cir. 1986) (per curiam) 41

United States v. Turkette, 452 U.S. 576 (1981) 39

United Steelworkers of America v. Warrior and Gulf Navigation Co., 363 U.S. 574 (1960) 11

Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831 (7th Cir. 1977) 19

West v. Drexel Burnham Lambert, Inc., 623 F. Supp. 26 (W.D. Wash. 1985) 47, 48

Wilko v. Swan, 201 F.2d 439 (2d Cir.), *rev'd*, 346 U.S. 427 (1953) 20

Wilko v. Swan, 346 U.S. 427 (1953) ..... *passim*

Wolfe v. E. F. Hutton & Co., 800 F.2d 1032 (11th Cir. 1986) (en banc) 18, 28, 32

Page

Statutes and Regulations

Securities Act of 1933, 15 U.S.C. § 77a *et seq.* 14

Section 8, 15 U.S.C. § 77h 15

Section 12(2), 15 U.S.C. § 77*l*(2) ..... *passim*

Section 14, 15 U.S.C. § 77n 6, 8, 20, 30

Section 19, 15 U.S.C. § 77s 15

Section 20, 15 U.S.C. § 77t 15

Section 22(a), 15 U.S.C. § 77v(a) 8

Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* i

Section 4, 15 U.S.C. § 78d 14

Section 9, 15 U.S.C. § 78i 15

Section 10(b), 15 U.S.C. § 78j(b) ..... *passim*

Section 19, 15 U.S.C. § 78s 15, 35

Section 19(b), 15 U.S.C. § 78s(b) 35

Section 20, 15 U.S.C. § 78t 39

Section 21, 15 U.S.C. § 78u 15

Section 27, 15 U.S.C. § 78aa 8, 32

Section 28(a), 15 U.S.C. § 78bb(a) 23

Section 29(a), 15 U.S.C. § 78cc(a) 6, 8, 25

Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.* i

	Page
18 U.S.C. § 1962	3
18 U.S.C. § 1962(c)	39
18 U.S.C. § 1963	39
18 U.S.C. § 1964(c)	39
United States Arbitration Act, 9 U.S.C. §1 *et seq.*	3
9 U.S.C. § 2	10
9 U.S.C. § 3	10
9 U.S.C. § 4	10
9 U.S.C. § 10	37
28 U.S.C. § 1254(1)	2
28 U.S.C. § 1292(a)(1)	6
17 C.F.R. § 240.10b-5	3
Legislative Materials	
116 Cong. Rec. 35, 190, 295, 342-47 (1970)	45
H.R. Rep. No. 96, 68th Cong., 1st Sess. (1924)	8, 11, 16
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Securities Act Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 (1975)	17

Page

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Page

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

No. 86-44

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

BRIEF OF PETITIONERS

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit is reported at 788 F.2d 94, and is reproduced in the Petition for a Writ of Certiorari (the "Petition") at Appendix B. The opinion of the United States District Court for the Southern District of New York is reported at 618 F. Supp. 384, and is reproduced in the Petition at Appendix C.

JURISDICTION

The judgment of the court of appeals was entered on April 16, 1986. The Petition was timely filed on July 14, 1986 and was granted on October 6, 1986. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED*

United States Arbitration Act

Section 2, 9 U.S.C. § 2
Section 3, 9 U.S.C. § 3

Securities Act of 1933

Section 12(2), 15 U.S.C. § 77*l*(2)
Section 14, 15 U.S.C. § 77n
Section 22(a), 15 U.S.C. §77v(a)

Securities Exchange Act of 1934

Section 10(b), 15 U.S.C. § 78j(b)
Section 29(a), 15 U.S.C. § 78cc(a)

Racketeer Influenced and Corrupt Organizations Act

Section 1962, 18 U.S.C. § 1962
Section 1964(c), 18 U.S.C. § 1964(c)

Securities and Exchange Commission Regulation

Rule 10b-5, 17 C.F.R. § 240.10b-5

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* The text of these provisions is reproduced in full at Appendix A.

STATEMENT OF THE CASE

From February 1980 through July 1982, respondents Eugene and Julia McMahon, either individually, jointly, or on behalf of various trusts, signed a series of Customer Agreements with a predecessor of Shearson Lehman Brothers Inc. ("Shearson"), a registered broker-dealer. Each of these agreements provides for arbitration of any controversy relating to the various accounts respondents maintained at Shearson. (R. 15). A typical agreement provides in part:

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I [the customer] may elect.

On October 26, 1984, respondents filed an action against Shearson and its registered representative Mary Ann McNulty in the United States District Court for the Southern District of New York. Respondents claimed that their securities accounts were mishandled by their broker. They alleged that there had been excessive trading in their accounts, that false statements were made and material facts omitted from the advice given to them, and that certain securities they purchased were not appropriate for their particular investment objectives. Respondents claimed that this conduct constituted: (a) common-law fraud, (b) a breach of fiduciary duty, (c) a violation of § 10(b) of the Exchange Act and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, and (d) a violation of § 1962 of the RICO statute. (R. 9). Shearson and Ms. McNulty moved for an order to enforce the arbitration agreement pursuant to § 3 of the United States Arbitration Act, 9 U.S.C. § 1 *et seq.*, which requires federal district court judges to compel arbitration of disputes encompassed by an arbitration agreement. (R. 10).

The District Court Opinion

The district court, Hon. Lloyd F. MacMahon, held that common-law causes of action are arbitrable under *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985). The court also conducted a two-part analysis and concluded that § 10(b) claims are arbitrable. The court initially conducted a statutory analysis similar to that used by this Court in *Wilko v. Swan*, 346 U.S. 427 (1953), wherein the Court refused to enforce a pre-dispute contractual agreement to arbitrate claims arising under § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2). The district court examined the distinctions between § 12(2) of the Securities Act, and § 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) and concluded that the *Wilko* doctrine is inapplicable to claims asserted under § 10(b) of the Exchange Act for the following reasons: (1) the "special right" created by Congress in § 12(2) which shifts the burden of proving lack of *scienter* to the defendant is not present in § 10(b); (2) the cause of action under § 10(b) is judicially implied unlike the express cause of action created by Congress in § 12(2); and (3) jurisdiction under the Exchange Act is limited to the federal courts and therefore narrower than jurisdiction under the Securities Act. *McMahon v. Shearson/American Express, Inc.*, 618 F.Supp. 384, 388 (S.D.N.Y. 1985), *aff'd in part, rev'd in part*, 788 F.2d 94 (2d Cir. 1986).

The court then addressed the decision of the court of appeals in *Allegaert v. Perot*, 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977), which held that § 10(b) claims are nonarbitrable. *Allegaert* involved a suit brought by trustees of a bankrupt securities brokerage firm against the New York Stock Exchange, Inc., several of its corporate members, and four individuals, alleging violations of the Bankruptcy Act, 11 U.S.C. § 701 *et seq.* (1979), the Exchange Act and various state laws. The court considered the factors relied on by the court of appeals in *Allegaert:*

> [T]he [Second Circuit] examined the "public interest in the dispute, the degree to which the nature of the evidence made the judicial forum preferable to

> arbitration, and the extent to which the agreement was a product of free choice." Pointing out that the case was "a claim of wholesale fraud" brought on behalf of hundreds of creditors, the court determined that the claim was imbued with strong public interest and protective public policy considerations which were inappropriate for enforcement by arbitration.

McMahon, 618 F. Supp. at 389 (citing *Allegaert*, 548 F.2d at 436-38). The court distinguished the underlying facts of this case from *Allegaert*, focusing on the absence of strong public interests in what is essentially a garden-variety dispute between a broker and its customers:

> We are not presented here with claims involving fraud, nor industry-wide practices which may tend to ensnare an unsuspecting public. Plaintiffs' claim is simply that a single securities representative "churned" their accounts and made certain misrepresentations concerning the status of those accounts. Such a dispute over the management of an account neither raises broad issues of policy nor involves widespread industry practices and, therefore, touches none of the concerns at stake in *Allegaert* which mandate a judicial forum.

McMahon, 618 F. Supp. at 389 (citing *Greater Continental Corp. v. Schechter*, 422 F.2d 1100, 1103 (2d Cir. 1970)). Accordingly, the court enforced the agreement to arbitrate the § 10(b) claims asserted by respondents.

The district court also held that it was barred from enforcing the agreement to arbitrate respondents' RICO claims, simply stating:

> The RICO claim is not arbitrable because of the important federal policies inherent in the enforcement of RICO by the federal courts.

Id. at 387 (citing *S. A. Mineracao da Trindade-Samitri v. Utah Int'l.*, 576 F. Supp. 566, 574-76 (S.D.N.Y. 1983)).

The court stayed federal proceedings of the RICO claims pending arbitration of the arbitrable claims. (R. 23). Respondents appealed the district court's order enforcing the agreement to arbitrate the § 10(b) claims pursuant to 28 U.S.C. § 1292(a)(1), and petitioners cross-appealed the denial of their motion to arbitrate the RICO claims. (R. 24, 25).

The Court of Appeals Opinion

The court of appeals held that common-law claims are arbitrable, but refused to enforce the contractual agreement of the parties to arbitrate claims asserted under § 10(b) of the Exchange Act. The court's refusal to compel § 10(b) claims to arbitration was based on: (1) the *Wilko* Court's reliance on the anti-waiver provision in § 14 of the Securities Act, 15 U.S.C. § 77n, which prohibits arbitration of § 12(2) claims, combined with that section's similarity to the anti-waiver provision in § 29(a) of the Exchange Act, 15 U.S.C. § 78cc(a); in addition to (2) public policy considerations which the court held required a judicial forum for the resolution of securities disputes. The court concluded that § 10(b) disputes were "properly litigated in the courts where a complete record is kept of the proceedings and findings and conclusions are made." *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94, 97 (2d Cir. 1986) (citing *Schechter*, 422 F.2d at 1103). The court considered, but refused to accept, the district court's conclusion that broad public policy issues were not present in the dispute between the parties:

> While a churning claim by its nature is limited to the specific accounts in question, such claims also reflect the public interest and are important in their deterrent effect. The securities laws generally, and the implied causes of action which the courts have recognized, are designed to protect the public, and particularly the less sophisticated investor.

Id. at 98.

The court of appeals also refused to enforce the contractual agreement of the parties to arbitrate civil RICO claims, because of perceived "strong public policy considerations:"

> In other contexts, we have recognized the inappropriateness of the United States Arbitration Act when strong public policy considerations are involved. In *American Safety Equipment Corp. v. J. P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968), we stated that "a claim under the antitrust laws is not merely a private matter. The Sherman Act is designed to promote the national interest in a competitive economy; thus, the plaintiff asserting his rights under the Act has been likened to a private attorney-general who protects the public's interest." 391 F.2d at 826. We hold that there are comparable concerns inherent in the enforcement of RICO claims.

Id. The court of appeals considered the rationale underlying this Court's decision in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985), which enforced a contractual agreement to arbitrate an international antitrust dispute, but nevertheless refused to extend *Mitsubishi* to the domestic arena. The court concluded:

> Enforcement of the RICO statute is particularly appropriate in a judicial forum because of strong policy concerns, the need for development of the record, and judicial clarification and resulting consistency in resolving disputes under this relatively new statute.

McMahon, 788 F.2d at 98-99.

SUMMARY OF ARGUMENT

Section 10(b) Claims Are Arbitrable

The refusal by the court of appeals to enforce an agreement between a broker-dealer and its customers to arbitrate claims asserted under § 10(b) of the Exchange Act conflicts with the explicit language and legislative history of the United States Arbitration Act as interpreted by this Court. Congress enacted the Arbitration Act in 1925 to overcome a long-standing judicial hostility to arbitration. The Act expresses congressional intent

to enforce contractual agreements of parties who desire a swift resolution of their disputes in an arbitral forum. H.R. Rep. No. 96, 68th Cong., 1st Sess. 1-2 (1924). This Court has consistently affirmed the national policy favoring arbitration of all arbitrable claims, and has held that a valid arbitration agreement shall be enforced as to a statutory claim unless Congress has evidenced a contrary intention in the statute or its legislative history. *Mitsubishi*, 105 S. Ct. at 3354-55.

An examination of the Exchange Act and its legislative history reveals no evidence of congressional intent to exclude claims asserted under § 10(b) of that statute from the mandate of the Arbitration Act. Accordingly, § 10(b) claims must be arbitrated when a valid arbitration agreement exists between contracting parties.

The contrary holding of the court of appeals is premised upon a misapplication of the Court's opinion in *Wilko v. Swan*, 346 U.S. 427 (1953). The *Wilko* Court held that Congress intended to create an exception to the Arbitration Act when it enacted § 12(2) of the Securities Act. The Court held that an agreement to arbitrate claims asserted under § 12(2) was a "stipulation" which waives compliance with § 22(a), 15 U.S.C. § 77v(a), the provision of the Securities Act that provides for concurrent federal and state court jurisdiction. *Wilko*, 346 U.S. at 434-35. Congress created in § 12(2) an express cause of action for purchasers of securities issued pursuant to an initial public offering which differs from the common-law fraud action because it shifts the burden of proof from plaintiff to defendant. 15 U.S.C. § 77*l*(2). The Court's holding was premised upon its belief that Congress would not want to entrust arbitrators with interpreting this unique "special right" without judicial instruction on the law and judicial review of an arbitrator's decision. *See Wilko*, 346 U.S. at 435-36.

The court of appeals noted the similarity between the anti-waiver provision contained in § 29(a) of the Exchange Act and its counterpart in § 14 of the Securities Act, and concluded, without further analysis, that Congress intended to prohibit waiver of the right to sue in federal court which is granted by § 27 of the Exchange Act. 15 U.S.C. § 78aa. The court's opinion

failed to address the *Wilko* Court's solicitude for the § 12(2) "special right." This right is not present in § 10(b), the elements of which more closely resemble that of arbitrable common-law fraud. The *Wilko* doctrine is inapplicable to § 10(b) solely on this basis.

The *Wilko* Court's anti-waiver analysis is also inapplicable to § 10(b), which is a judicially-created, implied right of action. Congress could not have intended to prohibit waiver of the right to assert § 10(b) claims in federal court when it never created a private cause of action under § 10(b) and, in fact, never even considered creating such an action. *See Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 196 (1976). Absent congressional intent, there is no basis for extending the *Wilko* Court's narrowly-crafted exception to the Arbitration Act for § 12(2) claims to prohibit arbitration of claims asserted under § 10(b) of the Exchange Act.

Although not a requirement for a finding that Congress did not intend to prohibit arbitration of claims asserted under § 10(b), this Court should nevertheless reject the *Wilko* Court's application of the anti-waiver provision to a jurisdictional clause. There is no evidence of congressional intent to support such an application. An anti-waiver provision applies to waiver of compliance with substantive liability under a statute, and should not be construed to bar a contractual agreement to enforce statutory rights in a congressionally-approved alternative forum. The *Wilko* Court's construction of an anti-waiver provision arises from the judicial mistrust of the arbitral forum for the resolution of statutory disputes which is inherent in the *Wilko* analysis. This mistrust is inconsistent with the congressional intent embodied in the Arbitration Act, and cannot be substantiated in light of the fair and efficient Security Regulatory Organization ("SRO") arbitral forums which exist for the resolution of securities disputes under the auspices of the congressionally-created Securities and Exchange Commission.

RICO Claims Are Arbitrable

The refusal by the court of appeals to enforce contractual agreements to arbitrate claims asserted under RICO is similarly unsupported by evidence of congressional intent deducible from

RICO or its legislative history. The RICO statute does not even contain an anti-waiver provision of the type found in the Securities Act and the Exchange Act. The public policy concerns relied on by the court of appeals constitute an impermissible basis for prohibiting arbitration of civil RICO claims when Congress has evidenced no intention to exempt civil RICO from the mandate of the Arbitration Act. These public policy concerns are nevertheless premised upon a misconception by the court of appeals that the deterrent purpose of civil RICO is more important than the congressional intent to compensate victims of organized crime. Arbitration forums are well equipped to compensate victims of civil RICO violations especially when, as here, the underlying RICO predicate offense is securities fraud. Furthermore, any public policy concerns are misplaced since the vast majority of civil RICO lawsuits involve routine commercial disputes having no connection with the congressional intent of halting the infiltration of legitimate business by organized crime.

ARGUMENT

I. The United States Arbitration Act Mandates Enforcement of Contractual Agreements to Arbitrate Statutory Claims Absent Congressional Intent to the Contrary.

The United States Arbitration Act provides that contractual agreements to arbitrate transactions involving commerce, "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The Act mandates that federal district courts shall direct the parties to an arbitration agreement to proceed to arbitration on issues as to which an arbitration agreement has been signed. 9 U.S.C. §§ 3-4. The language of the Act is the starting point in construing its application to statutory claims. *Randall v. Loftsgaarden*, 106 S. Ct. 3143, 3150 (1986) (citing *Sante Fe Industries, Inc. v. Green*, 430 U.S. 462, 477 (1977)). The Arbitration Act does not prohibit the enforcement of contractual agreements to arbitrate any particular type of claim, statutory or otherwise. The plain meaning of the Act requires the enforcement of arbitration agreements with respect to any arbitrable claims.

The legislative history of the Arbitration Act also supports the plain meaning of the Act, and further evidences congressional intent to enforce contractual agreements to arbitrate. The legislative history demonstrates that Congress enacted the Arbitration Act as a result of an anachronism of American law. Historically, English courts refused to enforce arbitration agreements because they were jealous of their own jurisdiction. H.R. Rep. No. 96, 68th Cong., 1st Sess. 1-2 (1924). As a result, this unwillingness to enforce arbitration agreements was firmly embedded in the English common law and was eventually adopted by the American courts. *Id.* at 2. Congress enacted the Arbitration Act to reverse this judicial hostility towards arbitration agreements:

> Arbitration agreements are purely matters of contract, and the effect of the bill is simply to make the contracting party live up to his agreement. He can no longer refuse to perform his contract when it becomes disadvantageous to him. An arbitration agreement is placed upon the same footing as other contracts, where it belongs.

Id. Congress also legislatively countenanced the ability of contracting parties to resolve their disputes in a manner which is simpler and more expeditious than federal or state litigation:

> [T]he party willing to perform his contract for arbitration is not subject to the delay and cost of litigation. Machinery is provided for the prompt determination of his claim for arbitration and the arbitration proceeds without interference by the court.

Id. at 2.

This Court has historically noted the strong congressional intent to favor arbitration agreements, and has instructed that they be liberally construed. *See, e.g., United Steelworkers of America v. Warrior and Gulf Navigation Co.*, 363 U.S. 574, 584-85 (1960). In recent case law, the Court has consistently affirmed the strong policies contained in the Arbitration Act,

notwithstanding the presence of other expressed judicial concerns. In *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983), the Court, in rejecting a district court's attempt to stay a federal action in which a party sought to compel arbitration in favor of a parallel state action, found that the Arbitration Act creates a body of "federal substantive law" which establishes and regulates the enforcement of arbitration agreements. The Court also held that "as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration . . . ." *Cone*, 460 U.S. at 24-25. Further articulation of the strong policies underlying the Arbitration Act are found in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), which reversed a decision of the California Supreme Court that upheld a state statute precluding arbitration provisions in franchise agreements. This Court stated:

> We discern only two limitations on the enforceability of arbitration provisions governed by the Federal Arbitration Act: they must be part of a written maritime contract or a contract "evidencing a transaction involving commerce" and such clauses may be revoked upon "grounds as exist at law or in equity for the revocation of any contract." We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law.

Southland, 465 U.S. at 10-11 (footnotes omitted). In *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985), the Court directly confronted the conflicting policies between the judicially-created "doctrine of intertwining" and the Arbitration Act. Some lower federal courts had developed the "doctrine of intertwining" in order to retain for judicial resolution arbitrable claims which they believed were sufficiently factually and legally intertwined with nonarbitrable claims under the federal securities laws.[1]

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[1] *See Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 693 F.2d 1023, 1027 (11th Cir. 1982); *Miley v. Oppenheimer & Co.*, 637 F.2d 318, 334-37 (5th Cir. 1981); *Cunningham v. Dean Witter Reynolds, Inc.*, 550 F. Supp. 578, 580-85 (E.D. Cal. 1982). Other federal courts rejected the "doctrine of intertwining" so as to "not substitute [their] own views of economy and

(footnote continued)

These courts invoked this doctrine to preserve their exclusive jurisdiction over the Exchange Act and to promote judicial efficiency by avoiding "piecemeal litigation." *See Byrd*, 470 U.S. at 217. This Court subordinated both of these judicial concerns to the congressional intent embodied in the Arbitration Act:

> The preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered, and that concern requires that we rigorously enforce agreements to arbitrate, even if the result is "piecemeal" litigation, at least absent a countervailing policy manifested in another federal statute.

Id. at 221. Most recently in *Mitsubishi*, this Court reaffirmed its longstanding national policy of enforcing agreements to arbitrate statutory disputes absent a countervailing policy manifested in another federal statute,[2] by ruling that antitrust disputes are arbitrable because there is no evidence in the antitrust statutes or their legislative history that Congress intended to preclude arbitration of these statutory claims. The Court rejected the notion that there is a pervasive public interest in the enforcement of antitrust claims that requires such claims to be heard in a judicial forum. *Mitsubishi*, 105 S. Ct. at 3355 (citing *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821, 827-28 (2d Cir. 1968)).

The plain language and legislative history of the Arbitration Act must be examined in light of the principles articulated by this Court when analyzing whether Congress intended to prohibit enforcement of a contractual agreement to arbitrate a statutory claim. Only Congress can exempt a statutory claim from a valid arbitration agreement and the mandate of the Arbitration

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(footnote continued)
efficiency for those of Congress." *Byrd*, 470 U.S. at 217 (citing *Dickinson v. Heinold Securities, Inc.*, 661 F.2d 638, 646 (7th Cir. 1981)); *Surman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 733 F.2d 59, 62-63 (8th Cir. 1984); *Liskey v. Oppenheimer & Co.*, 717 F.2d 314, 317-21 (6th Cir. 1983).

[2] "Sometime ago this Court expressed hope for [the Arbitration Act's] usefulness both in controversies based on statutes or on standards otherwise created . . . . " *Mitsubishi*, 105 S.Ct. at 3354 (citing *Wilko*, 346 U.S. at 432).

Act, and any such congressional intent must be manifested in a statute or its legislative history. *Mitsubishi*, 105 S. Ct. at 3355; *Byrd*, 470 U.S. at 221; *Wilko*, 346 U.S. at 434-35.

II. Congress Did Not Intend to Create an Exception To the Arbitration Act Prohibiting the Enforcement Of Contractual Agreements to Arbitrate Claims Asserting an Implied Right of Action Under § 10(b) Of the Exchange Act.

This Court recently noted that the enforceability of an agreement to arbitrate a statutory claim is determined by examining congressional intent:

> We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history.

Mitsubishi, 105 S. Ct. at 3355. It is therefore necessary to scrutinize the text of § 10(b) and the Exchange Act as well as its legislative history to determine whether Congress intended to exempt this statute from the Arbitration Act.

Congress enacted the Securities Act in 1933, 15 U.S.C. § 77a *et seq.* (1982), and the Exchange Act in 1934 to regulate transactions in securities. The Securities Act was generally designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce. *See* H.R. Rep. No. 85, 73d Cong., 1st Sess. 1-5 (1933). The Exchange Act was enacted to protect investors against the manipulation of stock prices through regulation of transactions consummated upon securities exchanges and in over-the-counter markets, and to impose regular reporting requirements on those companies which have stock listed on national securities exchanges. *See* S. Rep. No. 792, 73d Cong., 2d Sess. 1-5 (1934). Congress created the Securities and Exchange Commission by enacting § 4 of the Exchange Act, 15 U.S.C. § 78d, and provided the Commission with various enforcement powers. *See, e.g.*, Securities Act, Sections 8,

19, 20, 15 U.S.C. §§ 77h, 77s, 77t; Exchange Act, Sections 9, 19, 21, 15 U.S.C. §§ 78i, 78s, 78u.

Section 10(b) of the Exchange Act makes it unlawful for any person, by use of agencies of interstate commerce or the mails, "[t]o use or employ, in connection with the purchase or sale of any security," whether or not registered on a national securities exchange, "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). In furtherance of its enforcement and rulemaking powers, the Commission prescribed Rule 10b-5.[3] Although the explicit language of § 10(b) does not by its terms create an express civil remedy for its violation, and there is no indication in the legislative history of the Exchange Act that Congress in adopting § 10(b), or the Commission when promulgating Rule 10b-5, contemplated such a remedy,[4] a private right of action for violations of § 10(b) and Rule 10b-5 has been created by judicial implication and is well established. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983); *Superintendent of Insurance v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971); *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946).

The mere existence of a judicially-created implied private right of action under § 10(b) does not evidence congressional intent to preclude arbitration of claims when parties have so contracted. It is one thing to infer that Congress intended a civil litigant to have the benefit of an implied right of action under § 10(b); it is quite another to infer that Congress intended to exempt § 10(b)

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[3] The full text of Rule 10b-5, 17 C.F.R. § 240.10b-5, is reproduced in its entirety at Appendix A.

[4] *See* L. Loss, *Fundamentals of Securities Regulation*, 821-22 (1983) (Section 10(b) was enacted to enable the Securities and Exchange Commission to investigate and obtain injunctive relief against corporate insiders who were buying their companies' stock. "[I] can vouch that nobody at the Commission table gave any indication that he was remotely thinking of civil liability."); *see also Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 729-30 (1975).

claims from the plain meaning of the Arbitration Act. Such an inference requires a finding that Congress intended to repeal the Arbitration Act, enacted in 1925, by implication, when it enacted the Exchange Act in 1934. This Court does not routinely repeal statutes by implication:

> It is, of course, a cardinal principle of statutory construction that repeals by implication are not favored.

Radzanower v. Touche Ross & Co., 426 U.S. 148, 154 (1976) (citing *United States v. United Continental Tuna Corp.*, 425 U.S. 164, 168 (1976)). The Court has also articulated the standard for repeal of a statute by implication when Congress has not evidenced its intent on the issue:

> In the absence of some affirmative showing of an intention [by Congress] to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable.

Morton v. Mancari, 417 U.S. 535, 550 (1974). The Arbitration Act and the Exchange Act are not irreconcilable. The purpose of the Arbitration Act is to enforce vigorously contractual agreements to arbitrate. H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924). The purpose of the Exchange Act is to protect investors against fraud in the secondary market. S. Rep. No. 792, 73d Cong., 2d Sess. 1-5 (1934). Both statutes co-exist without conflict. The Arbitration Act is applicable only when parties voluntarily enter into a contractual agreement to arbitrate. If there is no agreement to arbitrate, a claim under the Exchange Act will remain in court. However, if agreed to, a party's claim under § 10(b) of the Exchange Act should be heard in an arbitral forum. This does not amount to a waiver of the protections afforded under § 10(b); it only results in an agreed-to change of forum. "[W]hen two statutes are capable of co-existence, it is the duty of the courts . . . to regard each as effective." *Mancari*, 417 U.S. at 551. Since the Arbitration Act and the Exchange Act are

reconcilable, contractual agreements to arbitrate claims asserted under § 10(b) of the Exchange Act should be enforced.[5]

Notwithstanding the lack of congressional intent in the Exchange Act to exempt § 10(b) from the Arbitration Act, a few of the lower courts have chosen to rely, in various degrees, on language in the House Conference Report to the Securities Act Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 (1975), as evidence of congressional intent to prohibit arbitration of § 10(b) claims. Congress amended § 28 of the Exchange Act in 1975 as part of its vast overhaul of the federal securities laws to preserve the right of securities exchanges and other self-regulatory organizations to adopt mechanisms for the resolution of their intramural disputes. The House Conference Report to the 1975 amendments contains the following language:

> It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan*, 346 U.S. 427 (1953), concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.

H.R. Rep. No. 229, 94th Cong., 1st Sess. 111, *reprinted in* 1975 U.S. Code Cong. & Admin. News 179, 321, 342.

The plain meaning of this language expresses congressional intent that the 1975 amendments not change the *Wilko* holding that claims arising under § 12(2) of the Securities Act are nonarbitrable. It is unclear why the conferees felt compelled to mention *Wilko* within the context of their amendment to § 28 of the Exchange Act. However, it is most probable that the conferees were aware that the provisions of the Exchange Act and the Securities Act often overlap, and they wished to ensure that their

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[5] "Of course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.' " *Mitsubishi*, 105 S. Ct. at 3354 (citing 9 U.S.C. § 2).

amendment to § 28 was not interpreted as a general congressional policy favoring arbitration of all securities disputes, since such a policy would include claims arising under § 12(2) of the Securities Act which *Wilko* held nonarbitrable. Apart from the plausibility of this construction of the House Conference Report, the plain language of the Report refers strictly to the holding in *Wilko* as it applies to pre-dispute agreements to arbitrate claims asserted under § 12(2) of the Securities Act.

A few lower courts have ascribed to a unique theory. These courts speculate that since Congress was aware of the *Wilko* decision it was also aware that as of 1975 one circuit court of appeals had extended the *Wilko* doctrine to § 10(b) claims. *See Moran v. Paine, Webber, Jackson & Curtis Inc.*, 389 F.2d 242 (3d Cir. 1968). These courts surmise that Congress impliedly consented to the *Moran* extension of *Wilko* to § 10(b) by not expressly amending the Exchange Act in 1975 to allow for arbitration of § 10(b) disputes between customers and broker-dealers. *See Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520, 523-24 (9th Cir. 1986); *Wolfe v. E.F. Hutton & Co.*, 800 F.2d 1032, 1037-38 (11th Cir. 1986) (en banc).

This analysis leads to a different conclusion when developed more fully. An assumption that Congress was aware of a 1968 Third Circuit case is unreasonable. It is more logical to assume that Congress was aware of and deferred to this Court's 1974 decision in *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974), which was rendered during a year in which congressional deliberations regarding the 1975 amendments were ongoing. Congress was then aware that the Supreme Court had specifically recognized that the *Wilko* doctrine did not necessarily apply to § 10(b). *Scherk*, 417 U.S. at 513-14. Since the conferees were aware that the *Wilko* doctrine applied only to § 12(2) of the Securities Act when they amended § 28 of the Exchange Act, the language in the House Report must be viewed as an indication of congressional intent to maintain the status quo.

The 1975 amendments to the federal securities laws did not involve arbitration of disputes between customers and broker-dealers. Therefore, there is no basis to broadly interpret the

language in the House Conference Report as an expression of congressional policy in this area. This Court has recognized the limited value of inference from congressional silence. *Girouard v. United States*, 328 U.S. 61, 69 (1946) ("it is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law"). There is no clear evidence in the "one ambiguous sentence" in the House Conference Report which would suggest a congressional intent to prohibit enforcement of agreements to arbitrate § 10(b) claims. *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, 1398 n.17 (8th Cir. 1986) (agreements to arbitrate § 10(b) claims enforceable); *see Hirschey v. F.E.R.C.*, 777 F.2d 1, 7-8 (D.C. Cir. 1985) (Scalia, J. concurring) (criticizing routine deference to the detail of congressional committee reports.). The absence in the Exchange Act and its legislative history of evidence expressing congressional intent to exempt claims asserted under § 10(b) of the Exchange Act from the Arbitration Act allows for only one conclusion. Congress intended to enforce contractual agreements of parties to arbitrate § 10(b) claims.

A. *Wilko v. Swan* Should Not Be Extended to Prohibit Enforcement of Agreements to Arbitrate Claims Asserted Under § 10(b) of the Exchange Act.

Numerous circuit courts of appeals have assumed that § 10(b) claims are nonarbitrable notwithstanding the absence of congressional intent supporting this position.[6] This assumption is based upon the Court's opinion in *Wilko* which involved a claim asserted under § 12(2) of the Securities Act[7] by a customer against

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[6] *See Surman*, 733 F.2d at 61-62; *Belke*, 693 F.2d at 1025-26; *DeLancie v. Birr, Wilson & Co.*, 648 F.2d 1255, 1258-59 (9th Cir. 1981); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1030 (6th Cir. 1979); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823, 827-29 (10th Cir. 1978); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831, 833-35 (7th Cir. 1977); *Allegaert*, 548 F.2d at 436-38; *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976); *Sibley v. Tandy Corp.*, 543 F.2d 540, 543 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977).

[7] Section 12(2) of the Securities Act, 15 U.S.C. § 77*l* (2), is reproduced in its entirety at Appendix A.

his stockbroker to recover damages as a result of alleged misrepresentations and omissions concerning a purchase of shares of common stock. The respondents in *Wilko* moved to stay the action under § 3 of the Arbitration Act pending arbitration of the dispute, pursuant to the broad arbitration agreement executed by the petitioner. The motion was denied by the district court. The court of appeals reversed, holding that § 12(2) claims were arbitrable since the plain meaning and strong policies evidenced by the Arbitration Act were superior to the policies underlying the Securities Act. *Wilko v. Swan*, 201 F.2d 439, 445 (2d Cir.), *rev'd*, 346 U.S. 427 (1953).

The *Wilko* Court reversed the decision of the court of appeals and held that a pre-dispute agreement to arbitrate claims asserted under § 12(2) of the Securities Act is void. The Court interpreted such an agreement to be a "stipulation" which waives compliance with § 22(a), the provision of the Securities Act that provides for concurrent federal and state court jurisdiction. *Wilko*, 346 U.S. at 434-35.

The Court's conclusion that the right to select the judicial forum to enforce § 12(2) claims is the kind of "provision" that cannot be "waived" under § 14 of the Securities Act [8] was based on its perception of several characteristics unique to § 12(2) and the Securities Act. First, the Act was designed to protect securities investors by requiring that issuers, underwriters and dealers of securities make full and fair disclosure of the character of securities sold in interstate and foreign commerce, and to prevent fraud in connection with such sales. *Id.* at 431. Second, § 12(2) of the Securities Act grants a "special right" to aggrieved purchasers of securities to effectuate the aim of the Securities Act. *Id.* The Court interpreted § 12(2) to create "a special right to recover for misrepresentation which differs substantially from the common-law action in that the seller is made to assume the burden of proving lack of scienter." *Id.* Third, the Court stated

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[8] Section 14 provides: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void." 15 U.S.C. § 77n.

that other factors, when taken together, militate against enforcing pre-dispute agreements to arbitrate § 12(2) claims. The "special right" created by § 12(2) is enforceable in any court of competent jurisdiction – federal or state – and removal from state court is prohibited. Additionally, a purchaser who brings suit in federal court has a wide choice of venue, the privilege of nationwide service of process, and the ability to escape the monetary jurisdictional requirement attendant to diversity cases since subject matter jurisdiction pertains to a federal question. *Id.*

The *Wilko* Court also expressed doubts about the capability of arbitrators to adjudicate § 12(2) claims and properly ensure that purchasers of securities receive the protections afforded by the congressionally-created "special right." The Court opined:

> Even though the provisions of the Securities Act, advantageous to the buyer, apply, their effectiveness in application is lessened in arbitration as compared to judicial proceedings.

Id. at 435. The Court held that the express congressional intent embodied in the "special right" created by § 12(2) provides a unique mechanism for the protection of investors in connection with the sale of securities which overrides the strong congressional policies inherent in the Arbitration Act. *See id.* Accordingly, the Court held that a contractual agreement to arbitrate claims asserted under § 12(2) of the Securities Act is void pursuant to § 14 of that Act.

1. Section 10(b) of the Exchange Act does not contain the "special right" granted by Congress to purchasers of securities in § 12(2) of the Securities Act.

The court of appeals extended the *Wilko* doctrine to claims asserted under § 10(b) of the Exchange Act based on the following factors:

> [T]he similarity of the non-waiver provisions, § 14 of the 1933 Act and § 29(a) of the 1934 Act, as well as

> the strong policy concerns inherent in the securities laws and the legislative history that preceded their enactment, support the compelling need for a judicial forum in the resolution of securities law disputes.

McMahon, 788 F.2d at 98. The deficiency in this analysis is that it fails to address characteristics unique to § 12(2) and the Securities Act which caused the *Wilko* Court to carve out a limited exception to the Arbitration Act:

> [T]he *Securities Act* was drafted with an eye to the disadvantages under which buyers labor. Issuers of and dealers in securities have better opportunities to investigate and appraise the prospective earnings and business plans affecting securities than buyers. It is therefore reasonable for Congress to put buyers of securities covered by *that Act* on a different basis from other purchasers.

Wilko, 346 U.S. at 435 (emphasis added). To compensate for the disadvantages of purchasers of securities issued pursuant to an initial public offering, the Securities Act requires issuers, underwriters, and dealers to make full and fair disclosure of the character of securities sold in interstate commerce. *Id.* at 431.

Congress created the "special right" in § 12(2) to effectuate the significant policies underlying the Securities Act. It is clear from the language in *Wilko* that the shifting of the burden of proof – the creation by Congress of the "special right" – was the primary reason why the *Wilko* Court found that Congress intended to exempt claims asserted under § 12(2) of the Securities Act from the Arbitration Act. Section 10(b) of the Exchange Act is devoid of this "special right." When enforcing a § 10(b) claim, the plaintiff sustains the burden of proof. *Ernst & Ernst*, 425 U.S. at 193.

A plaintiff suing under § 12(2) of the Securities Act is also entitled to the following procedural rights created by Congress

to enforce the "special right" embodied in § 12(2): (1) concurrent state and federal court jurisdiction; (2) prohibition against removal from state court if suit is brought there; (3) a broad choice of venue; (4) the privilege of nationwide service of process; and (5) the lack of the jurisdictional monetary requirement attendant to diversity cases. *Wilko*, 346 U.S. at 433. Although a plaintiff asserting a claim under § 10(b) enjoys the benefit of a broad choice of venue, nationwide service of process, and the lack of the jurisdictional monetary requirement attendant to diversity cases, any emphasis on the respective procedural rights offered by the Securities Act and the Exchange Act is misplaced since the *Wilko* Court found these procedural rights significant only to the extent they enable a defrauded purchaser to enforce the "special right" present in § 12(2).[9]

In addition to the "special right" to shift the burden of proof emphasized by the *Wilko* Court, Congress in § 12(2) created a cause of action whereby a purchaser can recover for misrepresentation without proving intent on the part of the seller. In contradistinction, a plaintiff asserting a cause of action under § 10(b) must prove *scienter* on the part of the defendant as he would in an action for common-law fraud. *Ernst & Ernst*, 425 U.S. at 193. Therefore, the § 10(b) implied right of action "is not so different" from a common-law fraud action which must be sent to arbitration when a motion to compel arbitration is made. *Byrd*, 470 U.S. at 225 (White, J. concurring).

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[9] Although not a consideration in *Wilko*, § 12(2) also enables the victim of prospectus fraud to demand rescission upon tender of the security, evidencing congressional intent to shift the risk of decline in the security's value to the seller. This provides § 12(2) with an additional measure of deterrence not found in § 10(b) which, pursuant to § 28(a) of the Exchange Act, 15 U.S.C. § 78bb(a), limits a buyer's recovery to compensatory or "actual" damages. *Randall v. Loftsgaarden*, 106 S. Ct. at 3151. *But see Blackie v. Barrack*, 524 F.2d 891, 909 (9th Cir. 1975) ("[w]hile out of pocket loss is the ordinary standard in a 10b-5 suit, it is within the discretion of the district judge in appropriate circumstances to apply a rescissory measure"), *cert. denied*, 429 U.S. 816 (1976); *see Affiliated Ute Citizens v. United States*, 406 U.S. 128, 155 (1972) ("where the defendant received more than the seller's actual loss . . . . damages are the amount of the defendant's profit").

The unique characteristics of § 12(2) and the Securities Act simply are not found in § 10(b) and the Exchange Act. Although the conduct prohibited by the statutes may overlap at times, a cause of action under § 10(b) and a cause of action under § 12(2) differ in material respects as to their elements, defenses, and measures of damages. The court of appeals did not address these material differences which preclude the application of the *Wilko* doctrine to § 10(b) of the Exchange Act. Furthermore, the reliance by the court of appeals on the semantic similarity of the anti-waiver provisions in both statutes as a basis to prohibit arbitration of claims asserted under § 10(b) is misplaced.

2. The anti-waiver provision in § 29(a) of the Exchange Act does not preclude enforcement of agreements to arbitrate the § 10(b) cause of action which was not expressly created by Congress.

The *Wilko* Court held that a contractual agreement to arbitrate a § 12(2) claim is void under the anti-waiver provision found in § 14 of the Securities Act, as a stipulation waiving compliance with § 22(a) of that Act, which section grants a plaintiff the right to sue in state or federal court.[10] The Court's conclusion was based on its interpretation of congressional intent and its assumption that Congress, in enacting § 14, intended to prohibit arbitration of § 12(2) claims:

> As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended § 14 to apply to waiver of judicial trial and review [of § 12(2) claims].

Wilko, 346 U.S. at 437 (citation and footnote omitted). This analysis simply cannot be transferred to § 10(b) of the Exchange Act, even assuming the validity of the analysis with respect to an express cause of action such as § 12(2) of the Securities Act. The court of appeals erred by merely noting the similarity between § 14 and § 29(a) and not analyzing the significant differences between § 12(2) and § 10(b).

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[10] Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), is reproduced in its entirety at Appendix A.

Section 29(a) of the Exchange Act provides:

> Any condition, stipulation, or provision binding any person to *waive compliance with any provision of this chapter* or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

15 U.S.C. § 78cc(a) (emphasis added). While the phrase "waive compliance with any provision of this chapter" is virtually identical to its counterpart in § 14 of the Securities Act, it is nevertheless literally inapplicable to an implied right of action under § 10(b). *Byrd*, 470 U.S. at 225 (White, J. concurring). While the existence of a judicially-created implied right of action under § 10(b) is undisputed, it is also undisputed that Congress never considered or intended for there to be a private remedy under § 10(b). *Ernst & Ernst*, 425 U.S. at 196. Since Congress did not create an express cause of action under § 10(b), and, in fact, did not consider the issue of civil liability under § 10(b) at all, it could not have intended the anti-waiver provision found in § 29(a) of the Exchange Act to prohibit waiver of the judicial forum for claims asserted under § 10(b). Absent congressional intent to the contrary, § 10(b) of the Exchange Act is subject to the mandate of the Arbitration Act. *See Mitsubishi*, 105 S.Ct. at 3355.

In fact, this Court has never refused to enforce a contractual agreement to arbitrate an implied right of action. On those few occasions when the Court has refused to enforce an agreement to arbitrate a statutory claim, it has done so in recognition of an express remedy created by Congress:

> The Court has repeatedly held that a decision by Congress to create a special statutory remedy renders a private agreement to arbitrate a federal statutory claim unenforceable. Thus, as I have already noted, the *express* statutory remedy, provided in the Ku Klux Klan Act of 1871, the *express* statutory remedy in the Securities Act of 1933, the *express* statutory remedy in the Fair Labor Standards Act, and the *express* statutory remedy in Title VII of the Civil Rights Act of 1964, each provided the Court with convincing

> evidence that Congress did not intend the protections afforded by the statute to be administered by a private arbitrator.

Mitsubishi, 105 S. Ct. at 3366-67 (Stevens, J. dissenting) (emphasis added) (footnotes omitted). It is clear that statutory claims are subject to the unequivocal language of the Arbitration Act. *See id.* However, the application of the Exchange Act's anti-waiver provision to the implied right of action under § 10(b) is unclear. When balanced, the clear congressional intent manifested in the Arbitration Act and its legislative history override this questionable application.

3. This Court has recognized that the *Wilko* doctrine does not necessarily apply to § 10(b) of the Exchange Act.

This Court first questioned *Wilko's* applicability to § 10(b) of the Exchange Act in *Scherk*, due to the significant differences between § 12(2) of the Securities Act and § 10(b). In *Scherk*, the Court was presented with the question of whether a contractual agreement to arbitrate claims asserted under § 10(b) was enforceable in an international context. The Court recognized that:

> [A] colorable argument could be made that even the semantic reasoning of the *Wilko* opinion does not control the case before us. *Wilko* concerned a suit brought under § 12(2) of the Securities Act of 1933, which provides a defrauded purchaser with the "special right" of a private remedy for civil liability. There is no statutory counterpart of § 12(2) in the Securities Exchange Act of 1934, and neither § 10(b) of that Act nor Rule 10b-5 speaks of a private remedy to redress violations of the kind alleged here. While federal case law has established that § 10(b) and Rule 10b-5 create an implied private cause of action, the Act itself does not establish the "special right" that the Court in *Wilko* found significant. Furthermore, while both the Securities Act of 1933 and the Securities Exchange Act

> of 1934 contain sections barring waiver of compliance with any "provision" of the respective Acts, certain of the "provisions" of the 1933 Act that the Court held could not be waived by *Wilko's* agreement to arbitrate find no counterpart in the 1934 Act.

Scherk, 417 U.S. at 513-14 (citations and footnotes omitted). The *Scherk* Court nevertheless based its decision to allow arbitration of § 10(b) claims on the international factual setting involved and the Court's attendant concerns for international comity, international conflict-of-laws problems, and a desire to provide parties to an international agreement with the certainty of knowing where their rights will be enforced if a dispute arises. *Id.* at 515-20. The Court chose not to expressly resolve the question of the *Wilko* doctrine's applicability to § 10(b) of the Exchange Act. *Id.* at 515.

Notwithstanding the "colorable argument" articulated in *Scherk*, which limits the *Wilko* doctrine to § 12(2) of the Securities Act, the lower federal courts had steadfastly refused to enforce contractual agreements to arbitrate claims asserted under § 10(b). *See* note 6. This trend was reversed when this Court issued its opinion in *Byrd* and noted that the arbitrability of § 10(b) claims was still an open question. *Byrd*, 470 U.S. at 215-16 n.1. Moreover, Justice White wrote separately in the concurring opinion in *Byrd* to express his belief that the applicability of the *Wilko* doctrine to § 10(b) claims "is a matter of substantial doubt." *Id.* at 224 (White, J. concurring). After thoroughly analyzing and comparing the elements of § 12(2) of the Securities Act and § 10(b) of the Exchange Act, Justice White concluded:

> *Wilko's* solicitude for the federal cause of action – the "special right" established by Congress – is not necessarily appropriate where the cause of action is judicially implied and not so different from the common-law action.

Id. at 225 (citations and footnote omitted). Justice White further admonished that "*Wilko's* reasoning cannot be mechanically transplanted to the 1934 Act." *Id.* at 224. Subsequently, a

majority of the district courts which reexamined the elements of § 12(2) and § 10(b) held that contractual agreements to arbitrate 10(b) claims are enforceable.[11] When these cases reached the various circuit courts of appeals, these courts, with one exception, uniformly adhered to their precedents arrived at prior to *Byrd* and held § 10(b) claims nonarbitrable.[12] An objective analysis reveals that the *Wilko* doctrine is limited to the unique elements found in § 12(2) and the Securities Act. Since § 10(b) does not contain these elements, there is no reason to exempt claims asserted under that section from the strict mandate of the Arbitration Act.

B. Congress Intended an Anti-Waiver Provision to Prohibit Waiver of Substantive Compliance With A Statute and Not to Preclude Enforcement of Statutory Rights in an Arbitral Forum.

This Court can enforce agreements to arbitrate claims asserted under § 10(b) of the Exchange Act by recognizing the important differences between § 12(2) and § 10(b) and refusing to extend the *Wilko* doctrine. Without overruling *Wilko*, this Court can, and should, reject the *Wilko* Court's statutory construction of the anti-waiver provision contained in § 14 of the Securities Act to prohibit waiver of the judicial forum

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[11] At the time the Petition was filed, petitioners were aware of 118 district court decisions ruling on the enforceability of agreements to arbitrate § 10(b) claims since *Byrd* was decided. Seventy-six decisions, or approximately 64%, held that § 10(b) claims were arbitrable, while 42 decisions, or approximately 36%, held that § 10(b) claims were nonarbitrable. A complete list of these district court decisions is contained in the Petition at Appendix E.

[12] *See McMahon*, 788 F.2d at 96-98; *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197, 1201-02 (3d Cir. 1986); *Wolfe v. E. F. Hutton & Co.*, 800 F.2d 1032, 1038 (11th Cir. 1986) (en banc); *Mayaja, Inc. v. Bodkin*, 803 F.2d 157, 162 (5th Cir. 1986). Only two courts of appeals purported to analyze the issue of *Wilko*'s applicability to § 10(b) of the Exchange Act free from the restraint of prior precedent. *See Conover*, 794 F.2d at 527 (agreements to arbitrate § 10(b) claims unenforceable); *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, 1398 (8th Cir. 1986) (agreements to arbitrate § 10(b) claims enforceable).

in favor of the arbitral forum for the resolution of § 12(2) claims, since this application was not based on congressional intent. *Wilko*, 346 U.S. at 437.

The *Wilko* Court's analysis was predicated upon two assumptions: (1) § 12(2) claims cannot adequately be resolved in an arbitral forum because arbitrators are incapable of properly making subjective findings about the purpose and knowledge of an alleged violator of the law without judicial instruction on the law; and (2) there are inadequate provisions in the Arbitration Act for judicial review of arbitration awards:

> As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress *must have intended* § 14 to apply to waiver of judicial trial and review.

Id. (citation and footnote omitted) (emphasis added). As a result of these assumptions, the Court concluded:

> This arrangement to arbitrate is a "stipulation," and we think the right to select the judicial forum is the kind of "provision" that cannot be waived under § 14 of the Securities Act.

Id. at 434-35.

The *Wilko* Court relied on its own concerns and assumptions about the doubts Congress must have had about the arbitral process notwithstanding the lack of any support for this position in the Arbitration Act.[13] The Arbitration Act, however, expresses

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[13] The *Wilko* Court also stressed the fact that a pre-dispute arbitration agreement would cause a security buyer to surrender one of the advantages of the Securities Act "at a time when he is less able to judge the weight of the handicap the Securities Act places upon his adversary." *Wilko*, 346 U.S. at 435. This assumption reflects judicial concerns not expressed in any portion of the Securities Act, which must in any event be subordinated to the express congressional approval of pre-dispute arbitration agreements in the Arbitration

(footnote continued)

clear congressional approval of arbitration as an alternative means for resolving disputes.[14] If Congress intended an anti-waiver provision to manifest a policy countervailing that of the Arbitration Act, this intent would be expressed in the language of a statute or its legislative history. Neither the Securities Act nor its legislative history expresses such an intent. Quite to the contrary, the plain meaning of § 14 prohibits pre-dispute agreements to waive substantive liability for violations of the Securities Act and does not preclude parties from voluntarily agreeing to resolve their disputes in an arbitral forum.[15] Section 14 voids contractual agreements whereby one party attempts to bind another party to a pre-dispute release from the duty of substantive "*compliance* with any provision of the [Securities Act]." 15 U.S.C. § 77n (emphasis added).

The interpretation of an anti-waiver provision to preclude waiver of substantive liability is supported by examining the historical application of such a provision. As recognized by a

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(footnote continued)

Act. If any credence is given to this theory, however, it must be limited to cases involving the express "special right" of § 12(2). An extension of this policy to § 10(b) claims would, in effect, require judicial voidance of pre-dispute agreements to arbitrate any statutory dispute notwithstanding the broad congressional mandate to the contrary.

[14] The *Wilko* Court recognized the congressional approval of the arbitral forum, although it did not find it dispositive:

> Congress has afforded participants in transactions subject to its legislative power an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration if the parties are willing to accept less certainty of legally correct adjustment.

Wilko, 346 U.S. at 438 (footnote omitted).

[15] "By agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than judicial, forum. It trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration." *Mitsubishi*, 105 S. Ct. at 3355.

noted securities law commentator, anti-waiver provisions were first applied in England. L. Loss, *Fundamentals of Securities Regulation* at 1189 n.51. Prior to 1900, English courts had honored stipulations which bound purchasers of securities to waive *substantive compliance* with statutory provisions so long as the courts were satisfied that the party waiving his substantive rights was not deceived into signing the agreement. *See, e.g., Greenwood v. Leather Shod Wheel Co.*, [1900] 1 Ch. 42 (C.A.); *Cackett v. Keswick*, [1902] 2 Ch. 456 (C.A.).

In response to the enforcement by the English courts of pre-dispute waiver agreements, the Parliament enacted identical anti-waiver provisions in sections 38(2) and 417(2) of the Companies Act of 1900:

> A condition requiring or binding an applicant for shares in or debentures of a company to waive compliance with any requirement . . . shall be void.

11 & 12 Geo. 6, ch. 38, §§ 38(2), 417(2). This provision was intended to prevent parties from waiving *substantive compliance* with the Companies Act which prevented misrepresentations in connection with the sale of securities that were the subject of a prospectus. *See* 84 Parl. Deb. (4th ser.) 1161 (1900). Since the enactment of the anti-waiver provisions in England, sellers of securities have been precluded from enforcing pre-dispute agreements wherein purchasers waived their right to enforce substantive compliance with the law. L. Loss, *Fundamentals of Securities Regulation* at 1189 n.52. Nothing in English common law, statute, or parliamentary history supports the *Wilko* Court's application of an anti-waiver provision to a jurisdictional clause.

The propriety of interpreting an anti-waiver provision to preclude waiver of substantive statutory liability was recently recognized by a circuit court of appeals judge:

> Were I writing on a clean slate, I might well be inclined to reach a result contrary to the *Wilko* Court. Section 14 of the 1933 Act renders void any provision

> binding a security purchaser to "waive compliance with any provision of the subchapter" or the relevant rules and regulations thereunder. A fair reading of this statute would prevent a purchaser from waiving a seller's compliance with the substantive provisions of the Act, *i.e.*, its reporting and disclosure requirements. By agreeing to arbitrate, the purchaser does not waive the Act's protection, but merely agrees to enforce the Act's provisions in a forum other than the courts.

Wolfe v. E. F. Hutton & Co., 800 F.2d 1032, 1039 (11th Cir. 1986) (en banc) (Tjoflat, J. concurring); *see also* Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 Minn. L. Rev. ____ (1987) (forthcoming Feb. 1987).

The *Wilko* Court's misinterpretation of the anti-waiver provision contained in § 14 of the Securities Act is highlighted by case law which has followed *Wilko*. In *Scherk*, this Court enforced a contractual agreement to arbitrate claims asserted under § 10(b) of the Exchange Act in an international context even though § 29(a) of the Exchange Act prohibits a stipulation "binding any person to waive compliance with any provision" of that Act which provides for exclusive jurisdiction in the federal district courts. Section 27, 15 U.S.C. § 78aa. Additionally, lower courts have agreed with Justice Jackson's concurring opinion in *Wilko* and have held that agreements to arbitrate § 12(2) claims entered into *after* a dispute has arisen are enforceable. *See, e.g., Coenen v. R. W. Pressprich & Co.*, 453 F.2d 1209, 1213 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972); *Gardner v. Shearson, Hammill & Co.*, 433 F.2d 367, 368 (5th Cir. 1970) (per curiam), *cert. denied*, 401 U.S. 978 (1971). These courts also allow parties to settle § 12(2) and § 10(b) claims without judicial approval, and to voluntarily submit these claims to arbitration. If the *Wilko* interpretation of an anti-waiver provision was correct, these judicially-created exceptions to § 14 and § 29(a) must be deemed impermissible usurpations of congressional authority. The proper interpretation is that an anti-waiver provision precludes an agreement whereby a purchaser waives his right to enforce a seller's

compliance with the substantive provisions of the law, and does not preclude a purchaser from agreeing to enforce those rights in a congressionally-approved alternative forum.

C. The Court of Appeals Erred by Relying On the *Wilko* Court's Misplaced and Outdated Concerns Regarding the Adequacy of Arbitral Forums to Resolve Federal Securities Law Disputes.

The *Wilko* Court's refusal to enforce a contractual agreement to arbitrate a § 12(2) claim was based in large part on its belief that arbitrators are not capable of adequately resolving such disputes. As the Court opined:

> Even though the provisions of the Securities Act, advantageous to the buyer, apply, their effectiveness in application is lessened in arbitration as compared to judicial proceedings. Determination of the quality of a commodity or the amount of money due under a contract is not the type of issue here involved. This case requires subjective findings on the purpose and knowledge of an alleged violator of the Act. They must be not only determined but applied by the arbitrators without judicial instruction on the law.

Wilko, 346 U.S. at 435-36. The *Wilko* Court's concerns are misplaced, and reflect a judicial mistrust of the arbitral process which was rejected by Congress when it enacted the Arbitration Act. Approximately thirty-five years after *Wilko*, these same doubts concerning arbitration of statutory disputes were expressed, without further analysis, by the court of appeals:

> [A]lleged violations of [§ 10(b) are] properly litigated in the courts where a complete record is kept of the proceedings and findings and conclusions are made.

McMahon, 788 F.2d at 97 (citing *Schechter*, 422 F.2d at 1103).

The concerns of the *Wilko* Court and the court of appeals are at variance with the view of this Court which recently reaffirmed its belief that the arbitral process is quite capable of

handling complex litigation:

> [W]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.

Mitsubishi, 105 S. Ct. at 3354. The Court's conclusion is even more applicable to securities arbitration. Even assuming that the *Wilko* Court's mistrust of the arbitral process was justified in 1953, arbitration procedures for the resolution of securities disputes have become increasingly sophisticated since *Wilko* was decided. Carefully developed procedures have been established by the securities industry under the auspices of the Securities and Exchange Commission.[16]

In June 1976, the Securities and Exchange Commission solicited comments from interested persons in furtherance of its plan to develop "a uniform system of dispute grievance procedures" for the resolution of securities disputes. SEC Securities Exchange Act Release No. 12528 (June 9, 1976), 9 S.E.C. Docket 833-35 (1976). In response to proposals submitted by the SROs, a Securities Industry Conference on Arbitration (hereinafter SICA), consisting of representatives of various SROs, the Securities Industry Association, Inc. and the public, was established in 1977. *See* Katsoris, *Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279, 283-84 (1984) (hereinafter Katsoris, *Arbitration*). SICA developed a comprehensive Uniform Code of Arbitration setting forth procedures to be followed in the arbitration of customer disputes with broker-dealers. The Uniform Code was adopted by the participating SROs during 1979 and 1980.[17] SICA has continued to meet

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[16] *See, e.g.*, Constitution of New York Stock Exchange, Inc., Art. XI, 2 N.Y.S.E. Guide (CCH) ¶¶ 1501-1503 (June 1985); Arbitration Rules 600-634 of the New York Stock Exchange, Inc., 2 N.Y.S.E. Guide (CCH) at ¶¶ 2600-2634 (Mar. 1985). *See also* Uniform Code of Arbitration, N.A.S.D. Manual (CCH) ¶¶ 3712-3743 (July 1986).

[17] Included among the participating SROs are the American Stock Exchange, Inc., the New York Stock Exchange, Inc., the Chicago Board Options

(footnote continued)

periodically to supplement and amend the Uniform Code as necessary. *Id.* at 284.

The Uniform Code of Arbitration was approved by the Securities and Exchange Commission which found it to be in the public interest and in furtherance of just and equitable principles of trade. *See* SEC Securities Exchange Act Release No. 16390 (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979). The Commission retains jurisdiction to correct any perceived abuses or unfairness in the arbitration rules, pursuant to § 19 of the Exchange Act, 15 U.S.C. § 78s. Section 19(b) of the Act requires the SROs to file copies of any proposed rule change with the Commission, which publishes notice of the proposed rule change and gives interested persons an opportunity to submit their views on the proposal. 15 U.S.C. § 78s(b). At the conclusion of this process, the Commission either approves or disapproves the change. This procedure applies to changes in the SRO arbitration rules, and it adds a further measure of public protection which did not exist when *Wilko* was decided.

The public customer is further protected by the Uniform Code's requirement that the SROs appoint arbitration panels which consist of a majority of arbitrators who are not affiliated with the securities industry. The public customer may, however, request an arbitration panel which consists of a majority of arbitrators from the securities industry. Katsoris, *Arbitration* at 285.

The concerns of the *Wilko* Court regarding the ability of arbitrators to apply the federal securities laws to the factual disputes before them are outdated. Arbitrators are generally selected by the various arbitration forums based upon their expertise in particular areas of the law. They are knowledgeable individuals who have experience working with these laws, such as attorneys specializing in securities law and retired judges, as well as businessmen and other individuals with extensive experience in

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(footnote continued)

Exchange, the Municipal Securities Rulemaking Board and the National Association of Securities Dealers, Inc. *See* Katsoris, *Arbitration* at 283 n.13.

arbitrating securities disputes.[18] The arbitration forums established by the SROs have arbitration counsel assigned to each hearing who are available to assist the arbitrators with questions of a legal nature. Arbitrators may also consent to the submission by parties of legal briefs on issues which they believe require clarification.[19] As a practical matter, however, the *Wilko* Court's concerns regarding the ability of arbitrators to properly construe the federal securities laws are misplaced since the types of securities cases arising under § 10(b) normally involve simple factual disputes. Section 10(b) suits brought by customers of broker-dealers routinely allege that a stockbroker: made various misrepresentations; failed to inform a customer of a relevant fact; "churned" a customer's account[20]; improperly executed a customer's order; or purchased securities which were unsuitable for the customer's investment objectives. Securities arbitrators are often better equipped than a jury to resolve these factual issues given their knowledge of the brokerage industry and the types of problems which commonly arise between customers and their stockbrokers. The instant case is a fairly typical § 10(b) lawsuit between a customer and a broker-dealer which easily could be handled in arbitration. As a practical matter, arbitration agreements are invoked primarily in § 10(b) actions between customers and broker-dealers. Other securities fraud actions such

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[18] In the five-year period from 1980 through 1985, approximately 10,000 arbitration cases were filed with the SROs. *See* Fifth Report of the Securities Industry Conference on Arbitration at 7 (Apr. 1986).

[19] The *Wilko* Court's concerns about the ability of arbitrators to determine the meaning of § 12(2) without judicial instruction do not extend to § 10(b). *See Wilko*, 346 U.S. at 436. Judicial interpretation of § 10(b) and Rule 10b-5 promulgated thereunder has been extensive, and arbitrators need only apply the fully developed law to the facts before them. "When we deal with private actions under [§ 10(b) and] Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn." *Blue Chip Stamps*, 421 U.S. at 737.

[20] Churning generally occurs when a broker, exercising control over the volume and frequency of the trading in his customer's account, abuses his customer's confidence for personal gain by initiating transactions which are excessive in view of the nature of the account. *Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983).

as those brought by customers against issuers or underwriters would not normally involve contractual agreements to arbitrate. There are simply no valid public policy reasons requiring the resolution of a typical securities dispute in federal court when parties have contracted to resolve such a claim more expeditiously and with less expense in an arbitral forum.[21]

The doubts expressed by the *Wilko* Court regarding the adequacy of judicial review of arbitration awards are similarly misplaced.[22] Notwithstanding the fact that judicial concerns of this type are an inappropriate consideration when determining the arbitrability of a statutory claim, it is clear that Congress has addressed this issue by providing mechanisms for judicial review of arbitration awards which, although limited, are consistent with the underlying purposes of arbitration. Explicit grounds for vacating arbitration awards are found in the Arbitration Act which provides for vacatur when the decision of the arbitrator is tainted by: (1) corruption, fraud, or undue means; (2) evident partiality or corruption of the arbitrators; (3) misconduct on the part of the arbitrators; or (4) the arbitrator exceeding or improperly executing his powers. 9 U.S.C. § 10.

Furthermore, while an arbitrator's award will not be set aside because of misinterpretation of the law, numerous lower courts

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[21] For a further discussion of the fairness, efficiency and sophistication of securities arbitration as administered by the SROs, *see* the *amici curiae* brief filed by the Securities Industry Association, Inc. For a detailed discussion of an alternative arbitration forum for the resolution of securities disputes, *see* the *amicus curiae* brief filed by the American Arbitration Association. Both briefs were filed on behalf of petitioners.

[22] The concerns expressed by the *Wilko* Court in 1953 about the adequacy of the arbitral process and the competency of arbitrators are invalid today given the forums and procedures which exist for securities arbitration as well as the competency of modern arbitrators. Furthermore, the *Wilko* Court's novel statutory construction of an anti-waiver provision emanated from its mistrust of arbitration rather than from any congressional intent evidenced in the Exchange Act or its legislative history. Accordingly, in addition to granting the relief sought by petitioners by refusing to extend the holding of *Wilko* to claims asserted under § 10(b) of the Exchange Act, this Court should also reject the *Wilko* doctrine and hold that claims asserted under § 12(2) of the Securities Act are arbitrable.

have relied on *dictum* in *Wilko*, and held that an arbitrator's award will not be confirmed if it is demonstrated that the arbitrator acted in "manifest disregard of the law." *See Siegel v. Titan Indus. Corp.*, 779 F.2d 891, 892 (2d Cir. 1985) (citing *Wilko*, 346 U.S. at 436-37); *see also, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 636 F. Supp. 444, 445 (S.D.N.Y. 1986) (manifest disregard of law under Rule 10b-4 required arbitrators' award to be vacated); *Swift Indus., Inc. v. Botany Indus., Inc.*, 466 F.2d 1125, 1130 (3d Cir. 1972); *San Martine Campania de Navegacion v. Saguenay Terminals, Ltd.*, 293 F.2d 796, 801 (9th Cir. 1961).[23] Two additional grounds for vacating an arbitration award have been judicially created. An award will be vacated if: (1) it is contrary to public policy; or (2) it is irrational. *Amoco Overseas Oil Co. v. Astir Navigation Co.*, 490 F.Supp. 32, 37 (S.D.N.Y. 1979); *Botany Indus. v. New York Joint Board*, 375 F.Supp. 485, 490 n.6 (S.D.N.Y.), *vacated on other grounds sub nom., Robb v. New York Joint Board*, 506 F.2d 1246 (2d Cir. 1974).

The congressional intent embodied in the Arbitration Act to limit review of arbitration awards in order to comport with the nature of the arbitral process was a calculated congressional decision which should not be overridden by the judiciary. Moreover, the Arbitration Act reflects a strong congressional policy in favor of reducing congestion in the federal courts. Such congestion is one of the most serious problems facing the federal judiciary today.[24] When parties agree that a claim should be resolved out of court, only explicit congressional intent should override that

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[23] Manifest disregard of the law can be ascertained by judicial review of the pleadings, the transcript of the proceedings, and the documentary evidence submitted at the hearing. Parties to an arbitration can always arrange for the appearance of a stenographer. *See* Rule 612 of the American Stock Exchange, Inc. Arbitration Rules; Rule 624 of the New York Stock Exchange, Inc. Arbitration Rules; Section 37 of the National Association of Securities Dealers, Inc. Code of Arbitration Procedure. Copies of these rules are contained in the supplemental lodging filed by the Securities Industry Association, Inc. in support of the Petition.

[24] Speech by Chief Justice Warren E. Burger to the American Arbitration Association and the Minnesota Bar Association, on August 21, 1985, reported by UPI on the same date; Speech by Chief Justice Warren E. Burger at New York University on November 18, 1982, reported in the Christian Science Monitor on November 24, 1982.

decision and require the expenditure of the time and resources required by a federal lawsuit. In this case, neither congressional intent nor the language of the Exchange Act requires such an expenditure of time and judicial resources.[25]

III. Congress Did Not Intend to Preclude Enforcement of Contractual Agreements to Arbitrate Claims Asserted Under RICO.

Congress enacted RICO principally to combat the "infiltration of legitimate business by organized crime." *United States v. Turkette*, 452 U.S. 576, 591 (1981). Congress provided for criminal penalties of imprisonment, fines, and forfeiture for violation of the provisions of RICO. 18 U.S.C. § 1963. It also provided for standing to bring an action under § 1964(c), 18 U.S.C. §1964, to private parties allegedly injured in business or property, who are further entitled to recover treble-damages by reason of a violation of § 1962.[26] Respondents invoked § 1964(c) to effectuate their RICO claims against petitioners, alleging that petitioners are liable to them under 18 U.S.C. § 1962(c) due to violations of the following predicate RICO activities: mail fraud, 18 U.S.C. § 1341; wire fraud, 18 U.S.C. § 1343; and fraud in the sale of securities in violation of §§ 10(b) and 20 of the Exchange Act, 15 U.S.C. §§ 78j(b), 78t. (R. 9).

This Court has held that a statutory claim will not be exempted from the clear mandate of the Arbitration Act absent congressional intent deducible from the statute or its legislative history. *Mitsubishi*, 105 S.Ct. at 3355. The text of the RICO

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[25] A finding that § 10(b) claims are arbitrable will also eliminate another source of waste – the maintenance of duplicative proceedings in separate forums. As a result of this Court's decision in *Byrd*, federal courts are required to compel arbitration of state law and common-law claims. *See Byrd*, 470 U.S. at 217. If at the same time courts are required to hear federal claims based on the same facts, parallel – and most likely duplicative – proceedings will result with attendant collateral estoppel problems. *Id.*

[26] The text of § 1962, 18 U.S.C. § 1962, is reproduced in its entirety at Appendix A.

statute is devoid of any language which precludes arbitration of civil RICO claims and RICO does not even contain an anti-waiver provision of the type which the *Wilko* Court relied upon in prohibiting arbitration of claims asserted under § 12(2) of the Securities Act. Nothing contained in the legislative history of RICO indicates that Congress intended to prohibit arbitration of civil RICO claims. Quite to the contrary, this Court has noted that Congress paid little attention to the private treble-damages provision contained in § 1964(c):

> Added to the House version of the bill after the original bill had been passed by the Senate, the private treble-damages provision later codified as section 1964(c) received relatively little discussion in either house of Congress.

Mayaja, Inc. v. Bodkin, 803 F.2d 157, 164 (5th Cir. 1986) (citing *Sedima, S.P.R.L. v. Imrex Co.*, 105 S.Ct. 3275, 3280 (1985)). The Third Circuit Court of Appeals has also noted the complete absence of legislative history regarding RICO's arbitrability which led that court to believe that Congress never considered whether arbitration of RICO claims should be prohibited. *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197, 1202 (3d Cir. 1986). The lack of indication in either RICO or its legislative history that Congress intended to create an exception to the Arbitration Act is sufficient evidence to find that no such exception was intended for civil RICO claims.[27] Congress was certainly aware of the Arbitration Act when it enacted RICO and it presumably would have addressed any conflict between that Act and RICO if it perceived one, either by directly prohibiting

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[27] The majority of the district courts ruling on this issue have followed this analysis. These courts were not bound by prior circuit precedent. At the time the Petition was filed, petitioners were aware of 47 district court decisions ruling on the enforceability of agreements to arbitrate civil RICO claims. Twenty-seven district court decisions held that civil RICO claims are arbitrable, while 19 decisions held that civil RICO claims are nonarbitrable. A complete list of these district court decisions is contained in the Petition at Appendix F. The only court of appeals to rule on the issue at the time the Petition was filed was the Second Circuit in *McMahon*, 788 F.2d at 98-99 (all civil RICO claims nonarbitrable based on public policy). Subsequently,

(footnote continued)

arbitration of civil RICO claims or, if *Wilko's* analysis is followed, by prohibiting waiver of the judicial forum in the form of an anti-waiver provision. Congress did neither and, accordingly, contractual agreements to arbitrate civil RICO claims should be enforced.[28]

A. The Public Policy Rationale Relied on by the Court Of Appeals for Prohibiting Arbitration of RICO Claims is Not Supported by the RICO Statute or Its Legislative History.

Although Congress did not evidence any intention in the RICO statute or its legislative history to prohibit enforcement of agreements to arbitrate RICO claims, the court of appeals nevertheless held that congressional policies underlying the RICO statute render RICO disputes unsuitable for resolution by arbitration. *McMahon*, 788 F.2d at 98-99. This holding was based upon the court's decision in *American Safety* which held antitrust claims nonarbitrable due to public policy considerations.

The analysis of the court of appeals must be rejected if the principles this Court set forth in *Mitsubishi* are to have any meaning at all. The *American Safety* doctrine authorizes a case-by-case judicial review of the purposes behind a particular statute to determine its arbitrability. However, every statute enacted by Congress is obviously a result of a legislative process that

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(footnote continued)

three additional courts of appeals have ruled on the issue, resulting in conflicting holdings among these courts. *Compare Jacobson*, 797 F.2d at 1202-03 (civil RICO claims arbitrable except when predicated on nonarbitrable offenses); *Tashea v. Bache, Halsey, Stuart, Shields, Inc.*, 802 F.2d 1337, 1339 (11th Cir. 1986) (per curiam) (civil RICO claims predicated on violations of the securities laws nonarbitrable); *Mayaja*, 803 F.2d at 162 & n.6 (civil RICO claims arbitrable).

[28] When Congress enacted RICO in 1970 as Title IX of the Organized Crime Control Act, Pub. L. 91-452, 84 Stat. 922, it did not intend to repeal the Arbitration Act by implication. The same argument that applies to petitioners' contention that the Exchange Act did not repeal the Arbitration Act by implication applies to RICO. *See* text at 16-17.

aspires to achieve a purpose, and there can be no doubt that there are strong policies inherent in every federal statute. Courts following *American Safety* can always override the clear congressional intent manifested in the Arbitration Act in favor of their own desire to keep statutory claims in a judicial forum. The Fifth Circuit Court of Appeals recently noted that the Second Circuit Court of Appeals' application of the *American Safety* doctrine to civil RICO claims in *McMahon* was inappropriate:

> We decline to follow *McMahon* because, as the Third Circuit [in *Jacobson*] noted, the *McMahon* court paid too little deference to the Supreme Court's decision in *Mitsubishi*. *McMahon* ignores *Mitsubishi's* instruction that congressional intent governs the analysis of arbitrability of a statutory claim under the Arbitration Act. After *Mitsubishi*, "determining statutory claims to be nonarbitrable on the basis of some judicially recognized public policy rather than as a matter of statutory interpretation is no longer permissible."

Mayaja, 803 F.2d at 163 n.6 (citations omitted).

Even if a public policy analysis of the type conducted by the court of appeals is applied, the policies underlying RICO do not conflict with the Arbitration Act. *American Safety* and *McMahon* reflect a misconception by the court of appeals of the primary congressional purposes underlying the antitrust laws and RICO. In *American Safety*, the court of appeals held that domestic antitrust claims are nonarbitrable because of the fundamental importance to American democratic capitalism of the antitrust laws. The court determined that this factor elevated the private cause of action and its attendant treble-damages feature granted by Congress in the antitrust laws into a right that could only be enforced in a judicial forum. The court held that the plaintiff in an antitrust action becomes a "private attorney-general" who protects the interests of the public at large, and, accordingly, his individual action is subordinate to the broader "public policy" underlying the antitrust laws. *American Safety*, 391 F.2d at 826. The court of appeals concluded that the "public" policy

behind the antitrust laws superseded the congressional policy in the Arbitration Act to enforce "private" agreements to arbitrate disputes.

Having articulated this distinction, the court discussed three additional reasons why it believed Congress must have intended such "public" disputes to be resolved in a judicial forum: (1) the arbitration agreement might be contained in a contract of adhesion; (2) antitrust issues are too factually and legally complex for arbitrators; and (3) arbitrators are generally businessmen who are themselves regulated by the antitrust laws, and therefore should not be determining issues of "public" interest. *Id.* at 827.

In *Mitsubishi*, this Court effectively rejected the *American Safety* doctrine. The Court relied on international aspects of the antitrust dispute involved in *Mitsubishi* to support its holding, but it nonetheless conducted an analysis of *American Safety* which left little doubt of its deficiencies. While the Court did not explicitly overrule *American Safety* in the domestic context, "*Mitsubishi* rejected so much of *American Safety*'s reasoning it is difficult to say what is left of the opinion to rely on." *Mayaja*, 803 F.2d at 163 n.6.[29] Most importantly, this Court examined and rejected the "core" of the *American Safety* doctrine; namely, the reliance by the court of appeals on the "public" deterrent function of the antitrust laws as a basis for prohibiting arbitration of antitrust claims. *American Safety*, 391 F.2d at 826. The Court in *Mitsubishi* analyzed the legislative history of the Clayton Act and the Sherman Act and concluded that although the "policing" function of the antitrust statutes exists, it is merely incidental to the private remedial function of the statutes. *Mitsubishi*, 105 S.Ct. at 3358-59.

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[29] The court of appeals limited the *Mitsubishi* analysis to the international setting involved in *Mitsubishi*, but failed to state why the principles set out in the Court's opinion would not apply equally to a domestic transaction. *McMahon*, 788 F.2d at 98. Both the Fifth and Third Circuit Courts of Appeals followed the *Mitsubishi* analysis and held RICO claims arbitrable in a domestic context in *Mayaja* and *Jacobson*, respectively. All but one of the 27 district court decisions holding RICO claims arbitrable, which are listed in the Petition at Appendix F, involved a domestic setting.

The Court stated:

> Notwithstanding its important incidental policing function, the treble-damages cause of action conferred on private parties by § 4 of the Clayton Act, 15 U.S.C. § 15 . . . seeks primarily to enable an injured competitor to gain compensation for that injury.
>
> . . . .
>
> When first enacted in 1890 as § 7 of the Sherman Act, the treble-damages provision "was conceived of primarily as a remedy for [t]he people of the United States as individuals. . . ."

Mitsubishi, 105 S.Ct. at 3359 (citing *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 486 n.10 (1977)). Furthermore, this Court in *Mitsubishi* expressed skepticism about each of *American Safety's* remaining reasons for requiring a judicial forum, concluding that these concerns were unfounded since: (1) arbitral forums are capable of handling complex matters; (2) there is no reason to assume without factual support that the arbitration clauses were contained in unenforceable contracts of adhesion; and, finally, (3) there is no reason to presume that arbitrators, although businessmen, would not be impartial. *See Mitsubishi*, 105 S. Ct. at 3357-58.

Notwithstanding this Court's prior rejection of *American Safety's* emphasis on the "public" nature of the antitrust laws as a basis for prohibiting arbitration of antitrust claims, the court of appeals relied on the identical analysis as a basis for prohibiting arbitration of RICO claims:

> In other contexts, we have recognized the inappropriateness of the United States Arbitration Act when strong public policy considerations are involved. In *American Safety Equipment Corp. v. J. P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968), we stated that "a claim under the antitrust laws is not merely a private matter. The Sherman Act is designed to promote the national interest in a competitive economy; thus, the plaintiff asserting his rights under the Act has been likened to a private attorney-general who protects the

> public's interest." 391 F.2d at 826. We hold that there are comparable concerns inherent in the enforcement of RICO claims.

McMahon, 788 F.2d at 98. The Court concluded:

> Enforcement of the RICO statute is particularly appropriate in a judicial forum because of strong policy concerns, the need for development of the record, and judicial clarification and resulting consistency in resolving disputes under this relatively new statute.

Id. at 98-99.

There is no basis for the strong deference given by the court of appeals to the deterrent function of the RICO statute. While the criminal RICO penalties serve a deterrent function, the legislative history of civil RICO emphasizes the congressional intent to compensate victims of organized crime. For example, Representative Steiger emphasized civil RICO's primary remedial function when he introduced the private treble-damages provision to the House Judiciary Committee:

> Not every businessman, of course, will wish to take advantage of such a remedy, but those who have been wronged by organized crime should at least be given access to a legal remedy. In addition, the availability of such a remedy would enhance the effectiveness of [RICO's] prohibitions.

Hearings on S. 30, and Related Proposals, before Subcommittee No. 5 of the House Committee on the Judiciary, 91st Cong., 2d Sess. 520 (1970). There are repeated references throughout the legislative history of RICO that the treble-damages feature in RICO was based upon the same purpose underlying § 4 of the Clayton Act, which is remedial in nature. *See* 116 Cong. Rec. at 35, 190, 295, 342-47 (1970). As the Fifth Circuit recognized in *Mayaja*:

> The primary purpose of [§ 1964(c)] is to compensate those injured by organized crime; the section's secondary purpose is to deter racketeers from inflicting such injuries.

Mayaja, 803 F.2d at 165.

The doubts expressed by the court of appeals in *McMahon* regarding the adequacy of the arbitral process are identical to those it set forth in *American Safety* which this Court rejected in *Mitsubishi*. 105 S. Ct. at 3354. Moreover, since the underlying fact pattern of an alleged civil RICO violation in a garden-variety securities fraud lawsuit is the same as that supporting violations of the federal securities laws, the arbitral forums established by the SROs and overseen by the Securities and Exchange Commission are well equipped to resolve civil RICO disputes. *See Jacobson*, 797 F.2d at 1203 ("the heart of the [RICO] dispute still will be over whether the securities laws were violated"). "So long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function." *Mitsubishi*, 105 S. Ct. at 3359-60.

The decision of the court of appeals is premised upon misconceptions about the congressional policies underlying RICO as well as baseless concerns regarding the ability of arbitrators to enforce these policies. This Court should defer to congressional intent and enforce the agreement of the parties to arbitrate their RICO disputes.

B. Public Policy Considerations are Nevertheless Misplaced Given the Nature of the Civil RICO Claims Presently Being Asserted in the District Courts.

Even if a public policy analysis of the type conducted by the court of appeals in *American Safety* and *McMahon* is appropriate, contractual agreements to arbitrate civil RICO claims should nevertheless be enforced since the vast majority of RICO claims do not impact on the general society or involve vital national interests. Indeed, as this Court recognized in *Sedima*, the majority of civil RICO claims have been asserted against

respected and legitimate enterprises, rather than against members of organized crime. *Sedima*, 105 S. Ct. at 3287; *see also The Supreme Court-Leading Cases*, 99 Harv. L. Rev. 120, 312-13 (1985) (the subject matter of private civil RICO actions is increasingly ordinary commercial fraud).

The underlying lawsuit is indicative of the typical RICO action that burdens the federal court system today, which frames, as a RICO claim, commercial disputes that otherwise would involve only claims of breach of contract, securities law violations, or fraud. *See Haroco, Inc. v. American Nat. Bank and Trust Co.*, 747 F.2d 384, 386-87 (7th Cir. 1984), *aff'd*, 105 S. Ct. 3291 (1985) (per curiam). Respondents allege securities fraud based upon churning and various misrepresentations committed by their former securities broker. Their RICO claims are premised upon the identical fact pattern supporting their fraud claims. This is a classic example of a plaintiff's "Pavlovian inclusion of a RICO claim" in almost every securities lawsuit. *Huss v. Goldman, Sachs & Co.*, 635 F. Supp. 1227, 1228 (N.D. Ill. 1986). As noted in *Huss*, plaintiffs in securities cases routinely assert claims under the federal securities laws, state blue sky laws, and RICO. *Id.* at 1227. This type of racketeering allegation has become the rule rather than the exception as RICO has become "essentially a federal business tort statute." *See, e.g., Brener v. Becker Paribas Inc.*, 628 F. Supp. 442, 450 (S.D.N.Y. 1985); *Bale v. Dean Witter Reynolds, Inc.*, 627 F. Supp. 650, 654 (D. Minn. 1986); *West v. Drexel Burnham Lambert, Inc.*, 623 F. Supp. 26, 28-29 (W.D. Wash. 1985).

A recent survey of trial court decisions conducted by the American Bar Association revealed that 77% of all civil RICO cases reported involved securities fraud or mail or wire fraud in a commercial or business setting.[30] In that same survey, the ABA

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[30] *See* Report of the Ad Hoc Civil RICO Task Force, A.B.A. Section of Corp., Banking & Bus. Law (1985) at 55-56 (hereinafter cited as ABA *Report*); *see also* Abrams, *The Civil RICO Controversy Reaches the Supreme Court*, 13 Hofstra L. Rev. 147, 153 n.31 (1985) ("prior to 1985, 77% of all civil RICO cases at the trial court level involved securities, mail or wire fraud in a commercial setting").

analyzed 270 RICO lawsuits and discovered that broker-dealers were the primary defendants in at least 40 of the cases, banks were the primary defendants in 32 cases, and lawyers and accountants were defendants in over 20 cases. These published judicial decisions clearly demonstrate the burgeoning use of civil RICO against reputable business and professional entities and persons. ABA *Report* at 35 n.41. Another survey of 132 published civil RICO decisions indicates that 63 cases arose out of securities transactions or commodities trading, and another 38 cases arose out of commerical and contractual disputes.[31] As noted in the AICPA *Report*, "cases that could fairly be characterized as having anything to do with aiding the war on organized crime are a tiny minority." AICPA *Report* at 15 (footnote omitted). It is therefore evident that RICO has "evolv[ed] into something quite different from the original conception of its enactors," since it has been utilized for purposes outside congressional intent to combat the infiltration of legitimate business by organized crime. *Sedima*, 105 S. Ct. at 3287.

In light of the universal recognition of the manner in which civil RICO has been misapplied, many of the district courts faced with RICO claims have concluded that such disputes can be resolved by arbitrators with no risk to any perceived public policy concerns. *See, e.g., Steinberg v. The Illinois Co.*, 635 F. Supp. 615, 619-20 (N.D. Ill. 1986); *Sacks v. Dean Witter Reynolds Inc.*, 627 F. Supp. 377, 379-81 (C.D. Cal. 1985); *see also West*, 623 F. Supp. at 29 ("there is no reason to pay lip service to a policy that justifies only a tiny minority of RICO cases"). Indeed, it is highly unlikely that the enforceability of arbitration agreements will *ever* arise in the types of cases that Congress envisioned when it enacted RICO. As one district court noted, a contract between a shopkeeper and an organized crime henchman who approaches him for protection money undoubtedly would not contain an

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[31] *See* American Institute of Certified Public Accountants, "The Authority to Bring Private Treble-Damage Suits Under 'RICO' Should Be Reformed," AICPA, *White Paper On Civil RICO* at 14-15 (July 31, 1985), *reprinted in* Oversight on Civil RICO Suits: Hearings on Oversight on Civil RICO Suits Brought Under 18 U.S.C. 1964(c) Before the Senate Committee on the Judiciary, 99th Cong., 1st Sess. 251 (1985) at 14-15 (hereinafter cited as AICPA *Report*).

agreement to arbitrate. *Ross v. Mathis*, 624 F. Supp. 110, 117 n.6 (N.D. Ga. 1985). Therefore, even if an examination of public policy considerations is part of a proper analysis in deciding whether contractual agreements to arbitrate civil RICO claims are enforceable, the public policy concerns of the court of appeals are meritless since simple commercial disputes do not implicate public policy.

CONCLUSION

Based on all of the foregoing reasons, the judgment of the United States Court of Appeals for the Second Circuit should be reversed insofar as it refused to enforce the contractual agreement of the parties to arbitrate claims asserted under § 10(b) of the Exchange Act and RICO.

Dated: New York, New York
November 19, 1986

Respectfully submitted,

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APPENDIX

APPENDIX A

STATUTORY AND REGULATORY PROVISIONS INVOLVED

United States Arbitration Act

9 U.S.C. § 2:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 3:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

Securities Act of 1933

Section 12(2), 15 U.S.C. § 77 l (2):

> Any person who –
>
> * * *
>
> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of

said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 14, 15 U.S.C. § 77n:

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

Section 22(a), 15 U.S.C. § 77v(a):

The district courts of the United States, the United States courts of any Territory, and the District Court of the United States for the District of Columbia shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in

equity and actions at law brought to enforce any liability or duty created by this title. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C. title 28, secs. 225 and 347). No case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assesed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

Securities Exchange Act of 1934

Section 10, 15 U.S.C. § 78j(b):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 29(a), 15 U.S.C. § 78 cc(a):

> Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

Racketeer Influenced and Corrupt Organizations Act

18 U.S.C. § 1962:

> (a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code, to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern or racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.
>
> (b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise

which is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsections (a), (b), or (c) of this section.

18 U.S.C. § 1964(c):

Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

Securities and Exchange Commission Regulation

Rule 10b-5, 17 C.F.R. § 240.10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

No. 86-44

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS

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COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

1. Whether a Purchaser of Securities May Be Compelled to Relinquish Substantive Federal Statutory Rights to Judicial Review and Trial By Jury of Claims Asserted Under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Section 78a *et seq.* (1982) (the "1934 Act"), in Contravention of: the Jurisdictional and Antiwaiver Provisions of the 1934 Act; the Clear Intent of Congress; the Unbroken Line of Precedents of This Court; and Overriding Public Policy Concerns?

2. Whether Claims Asserted Under the Racketeer Influenced And Corrupt Organizations Act, 18 U.S.C. Section 1961 *et seq.* (1982) ("RICO") May Be Enforced in Other Than a Judicial Forum in Light of Legislative Intent and Legitimate Public Policy Concerns?

RULE 28.1 LIST OF PARTIES

See Petition at ii-iii; Brief for Petitioners at ii.

TABLE OF CONTENTS

	Page
Counterstatement of Questions Presented	i
Rule 28.1 List	ii
Table of Authorities	v
Statutory and Regulatory Provisions Involved	xv
Opinions Below	1
Jurisdiction	1
Counterstatement of the Case	1
Summary of Argument	4
Argument	7
I. The Countervailing Federal Policies Inherent in the 1934 Act, and Congressional Intent Underlying the Enactment of Its Remedies, Compel an Exception to the Federal Arbitration Act	7
A. The Text and Legislative History of the 1934 Act Make Unenforceable Pre-dispute Agreements to Arbitrate Claims Arising Under the Act	7
B. The Adequacy of The Arbitral Forum to Resolve Federal Securities Law Disputes Is Relevant to Whether Public Customers May Be Compelled to Prospectively Forfeit Their Federal Statutory Right to Judicial Scrutiny of Such Claims	21

Page

C. Congress' Continuing Inquiry Into the Effectiveness of the Regulatory Scheme Governing the Securities Markets Manifests Its Overriding Solicitude for Protecting and Strengthening the Full Panoply of Rights of Public Customers Under the Securities Laws 29

D. The Fundamental Goals of the 1934 Act Are Impermissibly Undermined By Prospective Waivers Of Its Statutorily Provided Rights 34

II. Compelling Legislative History and Public Policies Preclude Arbitration of Civil RICO Claims 38

A. Congress Intended to Create An Exception to the FAA for Civil RICO Claims 38

B. Public Policy Considerations Bar the Arbitration of RICO Claims 42

Conclusion 45

TABLE OF AUTHORITIES

Cases	Page
Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972)	34
AFP Imaging Corp. v. Ross, 780 F.2d 202 (2d Cir. 1985), *cert. denied*, 106 S. Ct. 3295 (1986)	16
Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974)	8, 25, 43
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Page

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Page

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Page

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Page

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Page

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Sections 2-4, 10, 9 U.S.C. Sections 2-4, 10

Securities Act of 1933 (the "1933 Act")

Section 12(2), 15 U.S.C. Section 771(2)
Section 14, 15 U.S.C. Section 77n
Section 22(a), 15 U.S.C. Section 77v(a)

Securities Exchange Act of 1934 (the "1934 Act")

Section 10(b), 15 U.S.C. Section 78j(b)
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Section 27, 15 U.S.C. Section 78aa
Section 28, 15 U.S.C. Section 78bb(b)
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Section 1961 (1), 18 U.S.C. Section 1961 (1)
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

No. 86-44

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS

OPINIONS BELOW

See Brief for Petitioners at 1.

JURISDICTION

See Brief for Petitioners at 2.

COUNTERSTATEMENT OF THE CASE

This action was brought by Eugene McMahon and Julia McMahon individually and on behalf of various trusts, The David J. Hodder & Son, Inc. Employee Pension Plan, The David J. Hodder & Son, Inc. Profit Sharing Plan, The Laurie Funeral Home, Inc. Employee Pension Plan and the Laurie Funeral Home Profit Sharing Plan (the "trusts") (collectively

"respondents"), against Shearson/American Express, Inc., the predecessor of petitioner Shearson Lehman Brothers Inc. ("Shearson"), a brokerage firm registered with the Securities and Exchange Commission, and against Mary Ann McNulty ("McNulty") (collectively "petitioners"), a registered representative, employee and vice president of Shearson. Shearson and McNulty were responsible for respondents' accounts during the time period referred to in the amended complaint (R. 11).

The amended complaint alleges in essence that petitioner McNulty, with the knowledge and consent of petitioner Shearson: engaged in the fraudulent and wilful churning, or practice of trading excessively solely to maximize commissions, not only of respondents' individual accounts, but also of the fiduciary accounts; intentionally and recklessly violated Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. Section 78j(b) (the "1934 Act") and SEC Rule 10b-5, 17 C.F.R. Section 240.10b-5, promulgated thereunder, by making false statements and omitting material facts in the advice and financial projections given to respondents; fraudulently dissipated the funds of respondent Julia McMahon and those of numerous other investors representing the general public in a scheme known as the "Golden Apple" investment fund; and violated the provisions of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. Section 1961, *et seq.* ("RICO") (R. 11). The amended complaint also alleges pendent common law claims of fraud, misrepresentation and breach of fiduciary duty (R. 11).

Respondents claim as a first count multiple acts of fraudulent, inappropriate and excessive trading on the part of petitioners in connection with the joint account of the individual respondents, in which, for example, over 400 options were allegedly traded with commissions totalling approximately $50,000. Respondents also allege claims of securities fraud by petitioners in relation to the four trust accounts named as parties herein, where over 3,500 option trades enabled petitioners to reap overall more than $200,000 in excessive commissions (R. 11). These options trades were not in accordance with respondents' stated conservative investment objectives, and were not suited to secure either the McMahon's or their employees' retirement objectives (R. 11).

The individual respondents, who are by trade funeral home directors, were unsophisticated in the securities field, having no college degrees nor financial industry acumen and no prior investment experience in anything more risky than, *e.g.*, municipal bonds, treasury bills and money market accounts. Petitioners, who actively sought and obtained complete discretion in the handling of these accounts, failed to disclose to these unsophisticated investors the volatility of the markets in which petitioners were risking respondents' personal investment funds, and the funds of the four pension trusts as alleged. The representations made by petitioners to respondents as asserted in the amended complaint, of a guarantee of appreciation through conservative investment policies, did not come to fruition. Indeed, the gravamen of the amended complaint is that the practices of petitioners caused substantial losses (R. 11).

The third count of the amended complaint alleges a scheme by petitioners to defraud respondent Julia McMahon and to utilize her good name in recruiting members of the general public to similarly invest in the so-called "Golden Apple" investment fund, where the dissipation of substantial investments was caused by the injudicious trading of options by petitioners (R. 11). The fourth, RICO count is pleaded on behalf of all respondents. It seeks treble damages for the underlying predicate offenses which comprise a pattern of illegal conduct allegedly aimed at defrauding the respondents and the general public (R. 11).

The course of the proceedings below began when respondents filed their complaint on or about May 11, 1984 (R. 1). Petitioners vigorously contested this matter for almost one year prior to bringing on their motion to compel arbitration which was the subject of the appeal below. On July 13, 1984, petitioners filed a notice of motion to dismiss the complaint (R. 4,5). Petitioners also filed their notice to take the depositions of the individual respondents (R. 6), however, no discovery took place because following the filing of an amended complaint by stipulation (R. 11), petitioners filed yet another motion to dismiss the amended complaint on January 14, 1985 (R. 12,13). During

the pendency of petitioners' second motion to dismiss, petitioners moved to compel arbitration of respondents' claims on April 15, 1985 (R. 17, 19), almost one year after the original complaint had been filed, and after petitioners had vigorously defended the lawsuit in the judicial forum during the lengthy period following the service of the original complaint.

Respondents, it should be emphasized, in opposition to the motion to compel, have never conceded that the purported customer agreements petitioners allege they signed are either valid, enforceable or represent a knowing waiver of their right to a judicial forum under the securities laws (R. 21, 22). After the district court compelled arbitration of all but the RICO claims, which were placed on its suspense docket (R. 25), respondents appealed to the United States Court of Appeals for the Second Circuit (R. 27). Petitioners cross-appealed the district court's denial of their motion to arbitrate respondents' RICO claims (R. 28).

On April 16, 1986, the Second Circuit affirmed in part and reversed and remanded in part, holding that the district court should not have departed from the rationale and policy considerations underlying this Court's earlier decisions and Second Circuit precedent in granting petitioners' motion to compel arbitration of 1934 Act claims (R. 40,41). The Second Circuit affirmed the district court's denial of petitioners' motion to compel arbitration of the RICO claims and the lower court's direction as to arbitration of respondents' state law claims (R. 40,41).

SUMMARY OF ARGUMENT

The Second Circuit Court of Appeals held unenforceable a pre-dispute customer/brokerage agreement to arbitrate claims arising under Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. Section 78j(b) and Rule 10b-5, 17 C.F.R. 240.10b-5, based upon congressional intent embodied in the statute, its legislative history, significant public policy concerns and over thirty years of judicial precedent.

Eight Circuit Courts of Appeals have followed and applied the precedent of the Supreme Court established in *Wilko v. Swan*, 346 U.S. 427 (1953), in acceding to Congress' intent that agreements to arbitrate claims asserted under the 1934 Act are stipulations waiving compliance with the substantive provisions of the statute including Section 27, 15 U.S.C. Section 78aa, which provides for exclusive federal jurisdiction. These decisions are consonant with the holdings of this Court, which have consistently recognized the continuing vitality of the *Wilko* rationale and the right of action under Section 10(b) and Rule 10b-5. The Court has deemed those rights to be as important as the right of action under Section 12(2) of the Securities Act of 1933, 15 U.S.C. Section 77l(2) (the "1933 Act"). Congress' intent to preclude enforcement of arbitration agreements that prospectively waive the judicial forum is as applicable to the 1934 Act as it is to the 1933 Act.

Broad questions of policy inherent in securities law claims mandate a judicial forum, with its attendant procedural and substantive safeguards, for the resolution of such statutory disputes in order to protect fully the rights of public customers. The adequacy of the arbitral forum to vindicate such fundamental rights, an issue raised by petitioners and the Securities and Exchange Commission as *Amicus Curiae*, has been severely criticized just recently by congressional investigative studies and hearings. The 99th and 100th Congress' current inquiry into financial market manipulation and insider trading abuses is motivated in large measure by the same policies that informed the enactment of the securities laws, and the *Wilko* case and its progeny: the protection of the public investor in the securities markets.

The self-regulatory regime that governs the financial markets has also come under congressional scrutiny to determine if, in fact, the system works. Although oversight authority is represented by the proponents of arbitration as a virtual guarantee of the adequacy and effectiveness of arbitral procedures in use at the self-regulatory organizations, this claim is subject to the Court's scrutiny, since the legislative evidence

strongly suggests that arbitration is inadequate to vindicate the public's rights under the federal securities laws.

Respondents, as public customers of the securities industry, are consumers in the financial markets whose fundamental rights under the securities laws are at risk by virtue of prospective waivers of the judicial forum. Congress, by providing public customers with statutory antiwaiver provisions, thereby intended to prohibit arbitration of claims asserted under Section 10(b).

Similarly, the nonarbitrability of claims asserted under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. Section 1961 *et seq.* ("RICO"), is evident in the statute itself and its legislative history. The parallel to the antitrust laws and the private attorney general model that governed Congress' enactment of RICO make enforcement of RICO

> "particularly appropriate in a judicial forum because of strong policy concerns, the need for development of the record, and judicial clarification and resulting consistency in resolving disputes under this relatively new statute."

McMahon v. Shearson/American Express, Inc., 788 F.2d 94, 98 (2d Cir. 1986).

Both the remedial and deterrent purposes of civil RICO were envisioned by Congress as necessary to effectuate its goal of combating organized criminality as it touches upon both legitimate and illegitimate businesses. To the extent that this Court found in *Sedima, S.P.R.L. v. Imrex*, ____ U.S. ____, 105 S.Ct. 3275, 3284 (1985), that § 1964(c) of RICO is quasi-criminal in nature, requiring the procedural and substantive due process protections typically associated with criminal proceedings, a judicial inference of Congressional intent to bar the arbitration of RICO's express rights of action is warranted.

ARGUMENT

I. The Countervailing Federal Policies Inherent in the 1934 Act, and Congressional Intent Underlying the Enactment of Its Remedies, Compel an Exception to the Federal Arbitration Act

A. The Text and Legislative History of the 1934 Act Make Unenforceable Pre-dispute Agreements to Arbitrate Claims Arising Under the Act

This case presents to the Court a significant question, apparently one of first impression, as to whether a public customer may be compelled by members of the brokerage industry to relinquish substantive federal statutory rights to judicial review and trial by jury of claims asserted under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Section 78j(b) (the "1934 Act") by virtue of a pre-dispute waiver which is in contravention of: the jurisdictional and antiwaiver provisions of the 1934 Act; the clear intent of Congress; the unbroken line of precedents of this Court and of the overwhelming majority of Circuit Courts; and overriding public policy concerns. Based upon the recent case law that has been developing in the lower courts on this issue, it is by no means overstating the case to assert that the Court's decision here will have a lasting effect now and in the future on the claims of hundreds of thousands of public customers who invest in the financial markets and thereby not only help to ensure the vitality of the capital markets but also generate substantial business and income for the brokerage industry.

This Court has often, in similar circumstances, sought to balance the mandate of the Federal Arbitration Act, 9 U.S.C. Section 1, *et seq.* ("FAA"), against its applicability in certain contexts of remedial, federal statutory legislation, and has in many cases, guided by legislative history and policy concerns,

found the FAA inapplicable.[1] In formulating exceptions to the scope of the FAA, and in other cases upholding its applicability, this Court has "focused not on sterile generalization, but rather on the substance of the transaction at issue, the nature of the relationship between the parties to the agreement, and the purpose of the regulatory scheme." *Southland Corp. v. Keating*, 465 U.S. 1, 20 (1984) (J. Stevens, concurring in part and dissenting in part); *Wilko v. Swan*, 346 U.S. 427, 438 (1953).

Section 2 of the FAA provides simply that a written arbitration agreement "shall be valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. Section 2. In this case, the countervailing exception to the FAA is manifested in the 1934 Act itself, a statute whose underlying policy and remedial scheme must be reconciled with the acknowledged provisions of the FAA. The starting point for this inquiry, however, is not the unembellished language of the FAA, but the remedial provisions of the 1934 Act, the legislative history of the 1934 Act and judicial interpretation thereof. *See Randall v. Loftsgaarden*, ___ U.S. ___, 106 S.Ct. 3143, 3150 (1986).

The Second,[2] Third, Fifth, Sixth, Seventh, Ninth, Tenth and Eleventh Circuits,[3] in other words, every other Circuit Court

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[1] *See McDonald v. City of West Branch, Michigan*, 466 U.S. 284 (1984) (upheld statutory cause of action under 42 U.S.C. Section 1983); *Barrentine v. Arkansas-Best Freight System, Inc.*, 450 U.S. 728, 743-45 (1981) (upheld statutory cause of action under Fair Labor Standards Act); *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 56-58 (1974) (upheld statutory cause of action under Title VII, Civil Rights Act of 1964).

[2] *McMahon v. Shearson/American Express, Inc.*, 618 F.Supp. 384 (S.D.N.Y. 1985), *aff'd in part, rev'd in part*, 788 F.2d 94 (2d Cir. 1986), *cert. granted*, 107 S.Ct. 60 (No. 86-44, October 6, 1986).

[3] *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197 (3d Cir. 1986), *cert. pending*, No. 86-487; *Mayaja, Inc. v. Bodkin*, 803 F.2d 157

(Footnote continued)

but two[4] that have decided this issue, either before or after *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985), have adhered to a long-settled rule embodying Congressional intent, federal policy, and case law following this Court's decision in *Wilko*, that pre-dispute arbitration agreements are unenforceable with respect to claims under Section 10(b) of the 1934 Act.

The Court in *Wilko* held that a provision compelling arbitration prospectively is in effect an impermissible agreement by the public customer to waive the right to the protections of a judicial forum, and that subsequent claims arising under Section 12(2) of the Securities Act of 1933, 15 U.S.C. Section 77l(2) (the "1933 Act"), are not amenable to arbitration even under an agreement which would otherwise be enforceable under the FAA.[5] *Wilko* held that Congress, in enacting the antiwaiver

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(Footnote continued)
(5th Cir. 1986); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017 (6th Cir. 1979); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831 (7th Cir. 1977); *Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520 (9th Cir. 1986), *cert. pending*, No. 86-321; *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823 (10th Cir. 1978); *Wolfe v. E.F. Hutton & Co.*, 800 F.2d 1032 (11th Cir. 1986) (en banc). The Fourth and D.C. Circuits do not appear to have ruled *per se* on this question to date. *See also Tashea v. Bache, Halsey, Stuart, Shields, Inc.*, 802 F.2d 1337 (11th Cir. 1986) (per curiam); *King v. Drexel Burnham Lambert, Inc.*, 796 F.2d 59 (5th Cir. 1986), *cert. pending*, No. 86-282; *Miller v. Drexel, Burnham, Lambert, Inc.*, 791 F.2d 850 (11th Cir. 1986) (per curiam); *DeLancie v. Birr, Wilson & Co.*, 648 F.2d 1255 (9th Cir. 1981); *Sibley v. Tandy Corp.*, 543 F.2d 540 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977); *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976).

[4] *Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc.*, ____ F.2d ____, Slip Op. No. 86-1021 (1st Cir. November 26, 1986); reprinted in [Current] Fed.Sec.L.Rep. (CCH) ¶ 93,001, 94,914-94,916; *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393 (8th Cir. 1986), *cert. pending*, No. 86-578.

[5] It should be noted that agreements to arbitrate existing as distinguished from prospective disputes are enforceable. *See, e.g., Gardner v. Shearson*
(Footnote continued)

provision found in Section 14 of the 1933 Act, 15 U.S.C. Section 77(n), intended to prohibit a waiver of Section 22(a) thereof, 15 U.S.C. Section 77(v)(a), which grants concurrent state and federal court jurisdiction. *Wilko*, *supra*, 346 U.S. at 437.

Subsequently, in *Scherk v. Alberto Culver Co.*, 417 U.S. 506 (1974), where a negotiated agreement to arbitrate a commercial dispute arose out of a purely international transaction, the Court found "considerations and policies significantly different from those found in *Wilko*." *Id.* at 515. Although the Court noted a "colorable" argument for circumscribing the scope of *Wilko*, based upon certain perceived facial distinctions between the 1933 and 1934 Acts, it did not actually decide the issue of the arbitrability of 1934 Act claims.

In *Byrd*, although the Court again declined to resolve the applicability of *Wilko* to Section 10(b) claims, since the question was not before it, the Court acknowledged the viability of *Wilko* with respect to 1934 Act claims:

> "The Court [in *Scherk*] did not, however, hold that *Wilko* would not apply in the context of a § 10(b) or Rule 10b-5 claim, and *Wilko* has retained considerable vitality in the lower federal courts. Indeed numerous District Courts and Courts of Appeals have held that the *Wilko* analysis applies to claims arising under §10(b). . ., and that agreements to arbitrate such claims are therefore unenforceable."

Byrd, *supra*, 470 U.S. at 215-16 n.1. *Byrd* held only that pendent state law claims are arbitrable.

Respectfully, despite the reservations noted by Justice White in the concurring opinion in *Byrd*, the public policy rationale

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(Footnote continued)
Hammill & Co., 433 F.2d 367, 368 (5th Cir. 1970), *cert. denied*, 401 U.S. 978 (1971); *Moran v. Paine Webber, Jackson & Curtis*, 389 F.2d 242, 246 (3d Cir. 1968).

enunciated by the Second Circuit's decision in this case,[6] and the remedial purpose of protecting investors intended by Congress in enacting the securities laws and in amending them in 1975 are still valid, as recognized by the great *majority* of the Circuit Courts These considerations alone justify the continued extension of the *Wilko*[7] holding to deny compelled arbitration of 1934 Act claims. Any attempt to limit the application of *Wilko* to 1934 Act claims based upon artificial distinctions between the 1933 Act and the 1934 Act should therefore be rejected as wholly inconsistent with the plain statutory meaning and legislative intent underlying the securities laws. *See* n.12, *infra*.

That Congress intended, by enacting Section 10(b) of the 1934 Act, to protect the less sophisticated investing public from acts of fraud and manipulative practices by the brokerage industry is clear from the text of the statute:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality

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[6] The *McMahon* decision manifestly does *not* reflect judicial distrust of arbitration by the Second Circuit, which has often stated that its decisions and policy reflect the contrary. *See, e.g., American Safety Equipment Corp. v. J.P. Maguire & Co.*, 391 F.2d 821, 827 (2d Cir. 1968), citing *South East Atl. Shipping Ltd. v. Garnac Grain Co.*, 356 F.2d 189, 192-93 (2d Cir. 1966); *Kulukundis Shipping Co., S.A. v. Amtorg Trading Corp.*, 126 F.2d 978, 985 (2d. Cir. 1942).

[7] The assumption as to the nonarbitrability of Section 10(b) claims following *Wilko* and prior to Justice White's concurrence in *Byrd* was widespread. *See Conover, supra*, 794 F.2d at 521-22, citing, *e.g.*, A. Jacobs, *The Impact of Rule 10b-5*, § 237.02 (1980); A. Bromberg & L. Lowenfels, 2 *Securities Fraud & Commodities Fraud* § 5.16 (410) (1985). In *Scherk v. Alberto-Culver Co., supra*, 417 U.S. at 524-34, Justices Brennan, White and Marshall, joining in the dissent by Justice Douglas, opined that *Wilko* logically extended to 1934 Act claims. In *Byrd* the issue of whether 1934 Act claims are arbitrable was not properly before the Court, since the broker did not seek to compel arbitration of the federal securities claims. *Dean Witter Reynolds, Inc. v. Byrd, supra*, 470 U.S. at 215-16. *See also* L. Loss, *Fundamentals of Securities Regulation* 1193 (1983).

> of interstate commerce or of the mails, or of any facility of any national securities exchange. . . .
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> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate *in the public interest or for the protection of investors.*"

15 U.S.C. §78j(b)(emphasis added).

Consistent with this statutory scheme to protect the public, the SEC promulgated Rule 10b-5:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

17 C.F.R. §240.10b-5.

The legislative intent embodied in the 1934 Act, although containing some ambiguity as is often the case with congressional enactment, strongly indicates that Congress intended to create the right of action to enforce the duties arising under Section 10(b) of the 1934 Act, and concurrently, that the right to a federal judicial forum to enforce these duties is a provision that cannot be waived under Section 29(a) of the 1934 Act, 15 U.S.C. Section 78cc(a). Section 29(a) provides that any "stipulation" waiving "compliance" with *any* provision of the 1934 Act is void and unenforceable. Section 27, as set forth in 15 U.S.C. Section 78aa, provides, in pertinent part, as follows:

> "The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have *exclusive jurisdiction* of violations of this chapter or the rules and regulations thereunder, and of *all* suits in equity and actions at law brought to enforce *any liability or duty* created by this chapter or the rules and regulations thereunder." (emphasis added).

By providing for narrow, exclusive federal jurisdiction in the 1934 Act, to cover broadly *all* suits to enforce any *duty*, Congress must have intended that this special right to a judicial, federal court forum given under Section 27 is unwaivable and may not be so easily forfeited by virtue of Section 29(a).

Concededly, Congress' intent in this regard is implicit in the remedial scheme of the federal securities laws. When a plaintiff brings an action pursuant to Section 10(b), that party does so typically to enforce the duty, imposed upon securities brokers by that statute, not to use any manipulative or deceptive device in connection with the purchase or sale of securities in interstate commerce. Petitioners, relying on certain superficial "express/implied" differences they perceive in the securities laws, urge that Section 29(a) does not apply to the jurisdictional grant of Section 27 of the 1934 Act in the same way that Section 14 applies to Section 22 of the 1933 Act (Pet. Brief on the Merits 24). Forcing this result, however, is an obviously strained and

wholly inappropriate reading of the statutory language of the 1934 Act. To require that Section 10(b) claimants *must* arbitrate their grievances pursuant to a prospective, pre-dispute waiver, as argued by petitioners and their *Amici Curiae*, would effectively *eliminate* the grant of federal court jurisdiction under the 1934 Act in similar cases and undercut the remedial purpose of the securities laws. Such a result would not only be incongruous, and inconsistent with Congress' intent, but would constitute a forfeiture by public customers of their federal statutory rights at a time when the proportionate growth of the financial markets and concomitant rise in customer complaints against the brokerage industry call for greater, not fewer protections for the investing public. *See* discussion, *infra*.[8]

Prospective agreements to arbitrate claims arising under the securities laws are thus in the nature of prohibited stipulations waiving compliance with substantive provisions of both Acts. Under the parallel jurisdictional provision of Section 22 of the 1933 Act, such a stipulation infringes upon the right of a customer to *select* from state or federal judicial fora. Even more significantly, under the 1934 Act, the pre-dispute "agreement" to arbitrate not only infringes completely upon the vested right of the public customer to *exclusive* federal court jurisdiction, but effectively nullifies any opportunity, in such cases of prospective waiver, for 1934 Act claims to be heard in a court of law. As was noted recently by the Ninth Circuit Court of Appeals:

> "This distinction is an even more forceful indication of Congress' intent that federal courts oversee the

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[8] Respondents also raised the issues below that, as a contract of adhesion, the purported arbitration clause should not be enforced routinely without close scrutiny by the courts (R. at 21, 22), and that fraud and overreaching in the inducement of having a customer unknowingly waive statutory rights under the 1934 Act, by signing the standardized form of customer agreement, are justiciable claims (R. at 21, 22). *See Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395, 403-04 (1967). Ultimately, however, the standard of arbitrability rests not solely upon notions of unequal bargaining power, *e.g.*, but upon a proper analysis of the federal securities laws and underlying policy considerations which bar the enforceability of such agreements. *See McMahon*, *supra*, 788 F.2d at 97-98.

> interpretation and application of the 1934 Act . . . . the factors that led the *Wilko* Court to conclude that Congress intended to preclude enforcement of arbitration agreements under the 1933 Act can be no less applicable to claims under the 1934 Act."

Conover v. Dean Witter Reynolds, Inc., *supra* n.3, 794 F.2d at 527.[9]

The Second Circuit in this case held that the semantic distinctions between the 1934 Act and the 1933 Act do not withstand close scrutiny because they are, in practical terms, distinctions without substantive differences:

> "As our late colleague, Judge Friendly, noted in *Colonial Realty v. Bache & Co.*, 358 F.2d 178, 183 n.5 (2 Cir.), *cert. denied*, 385 U.S. 817 (1966), the non-waiver provision of §14 of the 1933 Act has an almost identical counterpart in §29(a) of the 1934 Act. In view of *Wilko* and the similarity of the non-waiver provisions of the 1933 and 1934 Acts, we consistently have held that §10(b) and Rule 10b-5 claims are not arbitrable. In *Greater Continental Corp. v. Schechter*, 422 F.2d 1100, 1103 (2 Cir. 1970), we observed that alleged violations of Rule 10b-5 were 'properly litigated in the courts where a complete record is kept of the proceedings and findings and conclusions are made.' We also pointed out the similarity between Section 14 of the 1933 Act and §29(a) of

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[9] *See also Barrowclough v. Kidder, Peabody & Co.*, 752 F.2d 923, 940 (3d Cir. 1985) ("There is an inherent incompatibility in referring to an arbitrator claims that fall within the exclusive jurisdiction of the federal courts and that arise as a part of a comprehensive scheme designed to assure protection to those individuals who fall within it. The Supreme Court has reached a similar conclusion with regard to analogous federal protective statutes."), citing *e.g.*, *Barrentine v. Arkansas-Best Freight System, Inc.*, *supra* n.1, 450 U.S. at 737.

> the 1934 Act. *Id.* In *Allegaert v. Perot*, 548 F.2d 432, 436-38 (2 Cir.), *cert. denied*, 432 U.S. 910 (1977), we reiterated the view that claims under §10(b) of the 1934 Act are not arbitrable, noting that the broad policy questions involved in securities law claims require a judicial forum for resolution of disputes. Again in *AFP Imaging Corp. v. Ross*, 780 F.2d 202, 205 (2 Cir. 1985), [*cert. denied*, June 30, 1986] we held that, in an action which alleged violations of §10(b) and Rule 10b-5, an arbitration clause in the contract was 'unenforceable under the law of this Circuit.' "

McMahon, *supra*, 788 F.2d at 96-97 (footnotes omitted).

Nothing in any of the recent decisions of this Court can be fairly interpreted as in conflict with the holding of the Second Circuit in *McMahon*. Indeed, even in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, ____ U.S. ____, 105 S. Ct. 3346 (1985), this Court clearly distinguished the international nature of the extensively and freely negotiated contract and antitrust dispute there, acknowledged an exception to arbitration in regard to claims in a domestic context and recognized that not all "controversies implicating statutory rights are suitable for arbitration." *Id.*, 105 S.Ct. at 3355.[10]

This Court has also determined that the provisions and remedies of the 1934 Act are not co-extensive with common law doctrines of fraud, [11] *Herman & MacLean v. Huddleston*, 459

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[10] *Mitsubishi* thus stopped short of overturning the "core" of the *American Safety* rationale that private plaintiffs, as quasi-attorneys-general, serve the public sector by enforcing their statutory rights and enforcing the regime of the antitrust laws, at least in the commercial domestic context, distinguishing international transactions. *Mitsubishi*, *supra*, 105 S.Ct. at 3358-3359.

[11] Section 10(b) plaintiffs must prove "scienter" by a preponderance-of-the-evidence standard while a fraud claimant at common law has a higher burden of proof by clear and convincing evidence. *See Herman & MacLean v. Huddleston*, *supra*, 459 U.S. at 388-389 (the Court found reference to common law standards "unavailing," since "an important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry." *Id.* at 389).

U.S. 375, 388-89 (1983), and that "a private right of action under Section 10(b) of the 1934 Act and Rule 10b-5 has been consistently recognized for more than 35 years. *The existence of this implied remedy is simply beyond peradventure.*" *Id.* at 380 (citations omitted, emphasis added) citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). In *Bateman Eichler v. Berner*, ____ U.S. ____, 105 S.Ct. 2622, 2628 (1985), the Court also rejected the argument that an implied remedy under Section 10(b) stood on any different footing from an express federal statutory remedy, citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975); *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964).[12]

As this Court acknowledged in *Herman and MacLean v. Huddleston*, *supra*, 459 U.S. at 384-389, the rights afforded public customers under the 1933 and 1934 Acts in support of their remedial purpose are cumulative and "[t]he effectiveness of the broad proscription against fraud in Section 10(b) would be undermined if its scope were restricted by the existence of an express remedy under Section 11." *Id.*, 459 U.S. at 386 (citations omitted). Under this Court's holding in *Herman & MacLean v. Huddleston*, any interpretation of the securities laws that would have the effect of displacing an action under Section 10(b) was explicitly rejected. *Id.*, 459 U.S. at 387. Accordingly, consistent with the Court's previous analysis in *Herman*

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[12] Similarly, taking a position contrary to that adopted by petitioners, the SEC as *Amicus Curiae* commendably urges the Court to eschew artificial distinctions between the Acts and any perceived differences based upon implied and express causes of action:

> "[T]he Commission believes that it is important for the Court to avoid deciding this case on the basis of any supposed distinction between the two Acts or between express and implied causes of action. In particular, in the Commission's view, reliance on any distinction between express and implied causes of action has no place in the analysis, would be inconsistent with prior decisions of this Court, and *might impair the protections of the securities laws.*" SEC as *Amicus Curiae* 21 (emphasis added).

& MacLean, it would be improper to undermine the so-called "implied" but judicially and congressionally recognized right of action under the 1934 Act, by, *e.g.*, construing the anti-waiver provision of Section 29(a) to be inapplicable to the jurisdictional grant of Section 27, simply because there exists an "express" remedy under the 1933 Act.

Congress' intent that the substantive protections of the 1934 Act must necessarily include the provision against pre-dispute waiver of the right to bring claims in a federal judicial forum, with the full panoply of rights to judicial review and trial by jury, is deducible from both text and the legislative history, and is consistent with the remedial purpose of the 1934 Act. In its 1975 examination and revision of the securities laws, Congress in effect ratified *Wilko* and left undisturbed the unbroken line of precedent in this Court and the Circuits upholding the judicial forum for 1934 Act claims.[13] The Ninth Circuit Court of Appeals, in *Conover v. Dean Witter Reynolds, Inc.*, *supra*, 794 F.2d 520, found the Conference Report of the Congress compelling evidence that the legislative branch would permit pre-dispute arbitration agreements *only* between industry professionals, *i.e.*, brokers and exchanges:

> "That [legislative and judicial] history tells us, first, that the implied cause of action in federal court under section 10(b) and Rule 10b-5 has become well-established, and its nonwaivable character has become well accepted by the Securities and Exchange Commission, the courts of appeals and Congress itself.
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> * * *
>
> The legislative and judicial history tells us, second, that Congress could have eliminated the federal cause of action for section 10(b) in 1975, when it undertook comprehensive revision of the 1933 and 1934 Acts, had it chosen to do so. Congress' revision, however, left section 10(b) intact.

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[13] *See* Securities Act Amendments of 1975, Pub.L. 94-29, 89 Stat. 97 (1975); H.R. Rep. No. 94-229, 94th Cong., 1st Sess. (1975); S.Rep. 94-75, 94th Cong., 1st Sess. (1975).

> The history tells us, third, and most important, that in 1975, *Congress expressly recognized the nonarbitrable nature of disputes between brokers and customers*. In the conference report to the Securities Act Amendment of 1975, Congress emphasized that its amendment to section 28 of the Securities Exchange Act of 1934, which permitted arbitration agreements between brokers and exchanges, did not extend to arbitration agreements between brokers and customers:
>
> > 'It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan*, 346 U.S. 427... (1953), concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.'
>
> H.R. Rep. No. 229, 94th Cong., 1st Sess. 111, *reprinted in* 1975 U.S. Code Cong. & Ad. News 321, 342."

Conover v. Dean Witter Reynolds, Inc., *supra*, 794 F.2d at 524 (citations omitted, emphasis added), citing *Hermann & McLean v. Huddleston*, *supra*; *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 379 (1982) (finding, analogously, comprehensive amendments to Commodities Act evidence that Congress intended preservation of implied remedy under the Act).[14]

Many of the eight Circuit Courts of Appeals that have recently endorsed the principle of the nonarbitrability of 1934 Act claims have explicitly found the 1975 revisions apposite to this analysis.

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[14] While respondents are also cognizant of Justice Scalia's remarks, stated while on the Circuit Court bench in *Hirschey v. F.E.R.C.*, 777 F.2d 1, 7-8 (D.C. Cir. 1985), with regard to the minute particulars of congressional deliberations, petitioners have taken those observations out of context. Here, the scope of Congress' 1975 amendments, especially with respect to the 1934 Act, invite us to revisit the 1975 Conference Report.

Notably, the Eleventh Circuit Court of Appeals' en banc panel in *Wolfe v. E.F. Hutton & Co.*, *supra*, 800 F.2d 1032, while discerning no more or less than a simple endorsement of *Wilko* in the Conference Report, nonetheless found that Congress "declined to take further action," thereby acquiescing in the application of *Wilko* to Section 10(b) claims by the Courts. *Id.* at 1037-1038. *See* Section 28(b), 15 U.S.C. Section 78bb(b).

That Congress found it necessary at all to amend the 1934 Act with respect to Section 28(b) is significant to this inquiry. Certainly, if the antiwaiver provision of Section 29(a) were *arguendo* to have been deemed not to prohibit a pre-dispute waiver of the right under Section 27 to bring Section 10(b) claims in a judicial forum, then Congress would not have carved out the unequivocal but limited exception to the antiwaiver provision under Section 28(b), permitting arbitration agreements between brokers and exchanges. This is precisely the evidence of congressional intent required under the *Mitsubishi* test, in which the Court assumed

> "that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention would be deducible from text or legislative history."

Mitsubishi, *supra*, 105 S.Ct. at 3355, citing *Wilko*.

The pre-dispute waiver at issue not only in this case, but in all the numerous cases now pending on the dockets of this Court and elsewhere, is unenforceable specifically because Congress has *not* excepted such pre-dispute arbitration agreements from the reach of Section 29(a). Congress clearly has never intended that relatively unsophisticated public customers could, unknowingly and in advance of a dispute, waive the protections of Section 29(a). When all factors are considered – the purpose, the legislative history and the focus and language of the statute itself – an exception to the FAA for respondents' claims under Section 10(b) of the 1934 Act must be upheld. This result is mandated by over thirty years of this Court's settled law and that

of the majority of the Circuits, the clear intent of Congress, established federal policy and the federal statutory rights afforded customers under the 1934 Act.

B. The Adequacy of The Arbitral Forum to Resolve Federal Securities Law Disputes Is Relevant to Whether Public Customers May Be Compelled to Prospectively Forfeit Their Federal Statutory Right to Judicial Scrutiny of Such Claims

Congress is today as concerned about protecting the public investor as it was when it enacted the securities laws over fifty years ago, and again when it enacted its comprehensive revisions in 1975. In its current session, the 100th Congress is embarking on a major reexamination of the effectiveness of the entire securities regulatory scheme in light of the damage recent insider trading cases have had on public investors' confidence in the fairness of the financial markets and the integrity of the brokerage industry. In the words of the Honorable John D. Dingell, Chairman of the House Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, Congress is currently scrutinizing the fundamental question of "whether self policing, in fact, works":

> "The U.S. capital markets have become the world's leaders precisely because of the strong public confidence in the basic integrity of those markets. *Events which shake that confidence — events which foster a public suspicion of unfairness — ultimately will destroy the effectiveness of those markets.*
>
> The hearing today is about just the kind of events which can destroy public trust and confidence. The questions we raise today about insider trading and stock manipulation will logically lead the Subcommittee in the coming year to look at corporate takeovers, leveraged buyouts, and the proper role of arbitrageurs.

In many ways, these are the same questions the House Commerce Committee was asking 50 years ago when it created the Securities and Exchange Commission and established the statutory framework for regulating the U.S. securities markets. At that time, the public was shocked by the revelations of stock manipulations, pools, insider trading and a host of other abuses. Now, we are facing what appears to be the biggest series of stock market abuses since the 1929 crash — abuses that led to the passage of the Securities Exchange Act of 1934.

* * *

At issue today is the effectiveness of the surveillance systems in the marketplace. Are the systems effective in deterring, detecting and prosecuting illegal trading? *What level of confidence can we have that individual investors are protected* against major institutional insider trading and stock manipulation?

The Levine and Boesky trading are good examples. The surveillance systems identified numerous Boesky and Levine trades, *but these referrals to the SEC did not lead to any enforcement action*. We must be careful not to be dazzled by the glitter of the technology of market surveillance and its effectiveness at this point. Before we can improve this system, *we have to face up to the clear limitations of the system*.

* * *

In fact, no one asked questions — not his employers — first Merrill Lynch and later Smith Barney — not the New York Stock Exchange, not the NASD, and not the SEC. Only when the broker began sharing his "tips" with a friend in Caracas did the scheme begin to unravel. His friend told a friend and together they began to piggyback as well. A third person, who

> was not cut in, apparently blew the whistle anonymously. Only with the anonymous tip did the Bank Leu/Dennis Levine scheme become clear and *has resulted in one of the greatest scandals since the creation of the SEC.*
>
> Over the next several months, the Subcommittee will examine these issues to determine whether the SEC needs additional authority to employ more radical investigative tools, and *whether self policing, in fact, works.*
>
> * * *
>
> Chairman Shad was finally convinced last Friday when at last he admitted that he did not have adequate enforcement personnel to police the securities markets."

Hearings Before the H.R. Subcommittee on Oversight and Investigations, *Insider Trading in the Securities Markets*, 99th Cong., 2d Sess. (Dec. 11, 1986) (opening statement of Hon. John D. Dingell, available from H.R. Committee on Energy & Commerce) (to be continued, 100th Cong., 1st Sess. 1987)).[15]

The gravity of this ongoing congressional inquiry into market abuses of monumental proportion and the inadequacies of self-regulation, begs the question of this Court whether, as a matter of congressional policy and intent, unsophisticated public customers should ever be compelled unknowingly, in advance of a dispute, to prospectively forfeit their statutory right to judicial scrutiny of their securities law claims, either under the 1933 Act or under the 1934 Act. Congress, by furnishing anti-waiver provisions to fortify the substantive arsenal of protections in both Acts, long-ago had the foresight to answer resoundingly in the negative. The public may *not* be compelled to forfeit such rights.

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[15] *See also* U.S. General Accounting Office, *Testimony: Insider Trading in the Securities Markets*, GAO/T-GGD-2 (Dec. 11, 1986) (statement of William J. Anderson Before H.R. Subcommittee on Oversight and Investigations) (available from H.R. Committee on Energy & Commerce).

Also at issue, in view of Congress' concurrent interest, is the adequacy of procedures to resolve customer disputes. There is ample evidence,[16] besides that represented by Congress' inquiry, to support this Court's finding as articulated in *Byrd* that the *Wilko* doctrine, together with its underlying rationale, is indeed still both good and necessary law in order to promote the confidence and protection of the public in the financial markets. *Byrd*, *supra*, 470 U.S. at 215-16 n.1. As one commentator has noted:

> "Arbitration procedures have not changed sufficiently since *Wilko* was decided to eliminate the Court's fundamental objections to allowing adversaries to arbitrate Securities Act claims. Arbitration is not as effective as adjudication in federal court as a means of protecting investors' rights because the purposes underlying arbitration fundamentally conflict with the right to a federal forum granted under the Securities Act and the Exchange Act."

Note, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 Duke L.J. 548, 552 and discussion with citations at 552-555. *See also* SEC Securities Exchange Act Release No. 20397 [1983-84 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,452 at 86,357 and n.6. (Nov. 18, 1983), discussed *infra*.

Contentions regarding the adequacy of the arbitral forum, while not dispositive of the question of the arbitrability *vel non* of statutory claims, have been raised by petitioners and *Amici* in support of petitioners. The issue is relevant here and must be addressed (*see* SEC as *Amicus Curiae* 7, 18-19), if the substantive remedies of the securities laws, enacted to protect the public customer, are to be left intact and accorded the importance that continues to be attached to them by Congress and the Courts,

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[16] The evidence is to be found in the relevant decisions of the eight Circuit Courts of Appeals, *supra* n.3.

and not least by the SEC, which today affirms that the Section 10(b) remedy is a significant adjunct to Commission oversight and action. SEC as *Amicus Curiae* 26. *See also J.I. Case Co. v. Borak*, *supra*, 377 U.S. at 432.[17]

Arbitration, while *relatively* quick, inexpensive and informal when compared to a court proceeding, must be balanced against the loss of constitutional guarantees of due process, trial by jury, findings of fact and conclusions of law, federal pleading, discovery and evidentiary rules, and compulsory, orderly discovery; the risk that the law will be improperly applied to the facts at issue; the possible risk of collateral estoppel or inconsistent verdicts; and the unlikelihood, if not unavailability, under various rules of the industry's self-regulatory organizations ("SROs"),[18] of the right to appeal. *See, e.g., Sobel v. Hertz, Warner & Co.*, 469 F.2d 1211 (2d Cir. 1972), *rev'g* 338 F.Supp. 287 (S.D.N.Y. 1971). The limited right to appeal is diminished still further because arbitrators are not required to state the basis for their decisions, thus eliminating any rational ground for testing the legal sufficiency or remedial adequacy of awards.

Remarkably, petitioner Shearson has invoked these same characteristics, supporting its own claims of irreparable harm and inherent unfairness of SRO arbitration proceedings, in memoranda its counsel has submitted in *Shearson Lehman*

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[17] *See generally Alexander v. Gardner-Denver Co.*, *supra*, 415 U.S. at 57, citing *U.S. Bulk Carriers v. Arguelles*, 400 U.S. 351 (1971) ("the choice of forums inevitably affects the scope of the substantive right to be vindicated."); *Bernhardt v. Polygraphic Co. of America, Inc.*, 350 U.S. 198 (1956) ("[A]rbitration, whatever its merits or shortcomings, substantially affects the cause of action created by the State. The nature of the tribunal where suits are tried is an important part of the parcel of rights behind a cause of action. The change from a court of law to an arbitration panel may make a radical difference in ultimate result.") *Id.* at 203.

[18] *See generally* Uniform Code of Arbitration, N.A.S.D. Manual (CCH) ¶¶ 3701-3743 (1986); Arbitration Rules of the American Stock Exchange, 2 Am. Stock Ex. Guide (CCH) ¶¶ 9540-9551J (1984); and Arbitration Rules of the New York Stock Exchange, Inc., 2 N.Y.S.E. Guide (CCH) ¶¶ 2600-2634 (1985).

Brothers, Inc. v. Lyle Lamers, No. B-86-507 (D.Conn. pending Oct., 1986) (TFGD), an injunctive action brought by Shearson in which it is, paradoxically, *opposing* the jurisdiction of the New York Stock Exchange to consider claims asserted by a public customer. The self-serving animus of the industry in promoting arbitration when it serves its purpose, but not consistently, is thus best illustrated by such methods used by brokers themselves to avoid arbitration and the jurisdiction of SROs. As noted by Donald Malawsky, senior vice present of enforcement at the New York Stock Exchange, brokers may thus thwart even the disciplinary efforts of the SROs: "the firm will settle up with a customer [before reaching the arbitration stage], and then he [sic] stops cooperating with us and won't be a witness," quoted in NEWSWEEK, December 22, 1986, at 43.

Furthermore, since judicial review of both SRO and American Arbitration Association ("AAA") decisions is strictly limited,[19] a repeal or even abridgement of the scope of *Wilko*[20] would effectively insulate the entire brokerage industry from statutory liability and judicial scrutiny of claims brought by public customers who have prospectively waived their rights arising

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[19] This is so in part because arbitration institutionalizes the practice of rendering decisions without giving reasons. According to the President of the AAA, Robert Coulson: "Written opinions can be dangerous because they identify targets for the losing party to attack." R. Coulson, *Business Arbitration — What You Need to Know* 26 (1980), cited in Note, *supra*, 1986 Duke L.J. at 553 n.37. Under the FAA, 9 U.S.C. §10, and the various uniform rules at the stock exchanges and elsewhere governing arbitration, the only limited grounds to challenge an award are: undisclosed relationship affecting impartiality of panel; corruption of arbitrator; unfair conduct of hearing; and relief not authorized under contract. Erroneous findings of fact or misinterpretations of law are not usually grounds for a court to reverse an award absent irrationality or manifest disregard of law. And arbitrators are not even bound to follow the precedent of prior awards. Note, *supra*, 1986 Duke L.J. at 553-54, n.38 and citations therein. *See also* J. Malcolm & E. Segall, *The Arbitrability of Claims Arising Under §10(b) of the Securities Exchange Act: Should Wilko Be Extended?*, 51 Albany L. Rev. 1 (forthcoming Winter 1987) (*accord* with premise of *McMahon*, *infra*).

[20] *See* AAA as *Amicus Curiae* 21; Brief for SEC as *Amicus Curiae*.

under both the 1933 and 1934 Acts. *Compare Axelrod & Co. v. Kordich, Victor & Neufeld*, 451 F.2d 838, 843 (2d Cir. 1971) ("Without such a [non-waiver] provision, financial houses might escape statutory liability by taking advantage of the inferior bargaining position of customers.").

The overriding policy consideration involved in this case is the protection of the public investor against manipulation and deception in the financial markets, the same consideration which culminated in Congress' enactment of the securities laws in the first place. As has been discussed above, there are many significant rights, both substantive and procedural, that are literally unavailable in the arbitration process. Consequently, when a customer is not given the opportunity to make an informed choice, and prospectively forfeits the judicial forum, the result is not only to give unfair advantage to the brokerage industry, but to encroach upon the very substantive rights provided in the 1934 Act, among them full disclosure, fair dealing and judicial scrutiny.

The SEC as *Amicus Curiae* 20-21, while suggesting that a "separate analysis would be necessary to determine whether the arbitration procedures [at other than SROs] are adequate to protect statutory rights," offers no proof for its perplexing assertion that as a result of its oversight authority, under Section 19 of the 1934 Act, 15 U.S.C. Section 78s, *et seq.*, *a fortiorari*, the "uniform" SRO arbitration procedures must be both adequate and fair. SEC as *Amicus Curiae*, *e.g.*, 20. This conclusion is offered without any explanation as to the manner in which SRO arbitration adequately protects public customers' statutory rights (including rights against pre-dispute waiver of the protections offered under the federal securities laws).[21] Neither the Securities

[21] Apparently, the SEC's position, which seems wholly inconsistent with SEC policy and releases, was reached only after strenuous debate among Commission staff. The Nat'l L.J., Dec. 15, 1986, at 15, cols. 1-4 ("The decision to file the brief, which reverses a position the SEC took . . . was controversial within the commission, according to sources familiar with the debate.").

Industry Association ("SIA")[22] nor the AAA, as *Amici Curiae*, adequately explains how the uniformity of these rules, without more, promotes fairness or the adequate enforcement of the securities laws. Ultimately, such issues of fairness, disclosure and protection of the rights of the public in the financial markets must be resolved in favor of the public securities consumer.[23]

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[22] The statistics cited, *e.g.*, by the SIA as *Amicus Curiae* 10-11, are misleading. There is no indication as to how many of the claims filed with the SROs arose under Section 10(b) as opposed to another statute, such as Sections 11, 12(2) or 17(a) of the 1933 Act, or how many were never subject to an arbitration agreement to begin with. *See also* AAA as *Amicus Curiae* 16 n.21. Moreover, in light of the evidence assembled by Congress, the increase in the number of arbitration filings is less a function of the acceptance of arbitration than a reflection of the exponential increase in customer complaints. In statistics compiled by Congress, in conjunction with the SEC, "the incidence of securities law violations is proportional to the size and activity of the securities market. From [1977 through 1983], the securities industry grew quite rapidly .... the number of shares traded on the New York Stock Exchange increased from 5.2 billion ... to 21.6 billion ... a net increase of over 300 percent .... The growth in the industry was accompanied by a corresponding increase in the indications of potential securities law violations. Specifically, the number of public complaints and inquiries to SEC alleging security law violations increased from 8,500 to almost 29,000 between fiscal years 1977 and 1983." U.S. General Accounting Office, Report to the Chairman, Subcommittee on Oversight and Investigation, Committee on Energy and Commerce, House of Representatives, *Statistics on SEC's Enforcement Program*, GAO/GGD-85-28 at 3 (Mar. 25, 1985).

[23] As an American Bar Association subcommittee has found in its preliminary (to date unpublished) inquiry, arbitration at the SROs is an inadequate procedure to enforce statutory duties under the securities laws. Practising Law Institute Forum, *Solving Securities Disputes* (Address by Sheldon H. Elsen, Esq., ABA Subcommittee Chairman, October 1, 1986). *See also* Victor, *Circuits Split on Securities Fraud Arbitration*, The Nat'l L.J., July 28, 1986, at 8, cols. 1-3. ("Most of the bar knows that it's a stacked deck in favor of the [investment] houses," quoting Sheldon H. Elsen, Esq.). Various consumer statutes have been enacted which in effect codify similar concerns about arbitral impartiality. *See, e.g.*, Consumer Product (Magnuson-Moss) Warranty Act, 15 U.S.C. §§ 2302(a)(8), 2310(d); N.Y. Gen. Bus. L. § 399-c (McKinney 1986-87) (prohibition of mandatory arbitration clauses).

C. Congress' Continuing Inquiry Into the Effectiveness of the Regulatory Scheme Governing the Securities Markets Manifests Its Overriding Solicitude for Protecting and Strengthening the Full Panoply of Rights of Public Customers Under the Securities Laws

It is respectfully submitted that the institution of SEC oversight authority over the SROs since 1975 is not an adequate reason for the Court to either "decide this case without broader consideration of the principles affecting the arbitrability of statutory claims generally" as is urged by the SEC as *Amicus Curiae* 14, or without a review of the fact that oversight alone has been found by Congress to be inadequate to protect the rights of public customers in its day to day dealings with the industry. While respondents do not wish to suggest, and have no independent means of determining, that the Commission does not provide excellent regulatory and rule-making guidance to the SROs, nevertheless, it is incontrovertible that as a practical matter it is left to the SROs and not the SEC to actually conduct the individual arbitration proceedings involving public customer-broker disputes.

Yet the failure of SRO procedures generally, in spite of SEC oversight, has been documented in detail by the U.S. General Accounting Office ("GAO"), the investigative arm of Congress, in its Report to the Chairman, Subcommittee on Telecommunications, Consumer Protection, and Finance, Committee on Energy and Commerce, House of Representatives, *Securities Regulation: Securities and Exchange Commission Oversight of Self-Regulation*, GAO/GGD-86-83 (Sept. 30, 1986) (hereinafter, "GAO Report on SEC Oversight"). While the GAO Report on SEC Oversight does not specifically comment upon arbitration procedures, it does underscore some significant failings of SRO handling of customer-broker disputes. For example, some SROs have experienced substantial backlogs in their handling of customer complaints and terminations of brokers for cause:

> "Between 1982 and 1984, the number of complaints received increased by 97 percent, the number resolved

> increased by 93 percent, and the number pending increased by 152 percent (to 1,565 actual cases). Moreover, the number of complaints that were pending for over 3 months grew by 218 percent (to 940 actual cases)."

GAO Report on SEC Oversight at 63. *See also* n.22, *supra*.

Another finding, germane to the activity public customers have with the SROs, is that "Commission [SEC] regional offices considered the SROs to be less able than the Commission to identify and take effective action on sales practice cases." GAO Report on SEC Oversight at 62. In practical terms, this means, for example, that SRO examinations are often not thorough; the review of customer accounts is based on a random sample rather than on a more time-consuming review of the most active accounts or the accounts that could be traded without the customer's knowledge; SRO examiners would thus not necessarily be looking at the accounts of public customers in sales practice matters, such as churning, most likely to be subject to abuse; and not least, the SROs lack sufficient personnel to handle sales practice matters. *Id.* at 62.

> "As a result of these perceptions, the [Commission's] regional offices appeared less likely to refer complicated sales practice violations to the SROs. Out of 117 closed referrals (referrals on which final SRO action had been taken) made to the SROs between January, 1983 and June, 1984, 46 had sales practice violations as the principal type of violation. Only 2 of the 46 cases concerned churning, considered a complicated sales practice violation; the remaining 44 sales practice matters that were referred and closed primarily involved the suitability of a security recommended for investment, considered a more straightforward violation to pursue."

Id. at 62. (citation omitted).

The virtual abandonment of the public customer's interests when they conflict with SRO "self-discipline" is apparently commonplace:

> "the prosecution of sales practice abuses highlighted a limitation of the self-regulatory system. . . . Even where SRO staff had aggressively investigated violations, disciplinary panels composed of members often appeared reluctant to sanction their peers."

GAO Report on SEC Oversight at 46-47. This conflict of interest, which spills over into SRO arbitrations where at least one panel member is typically an industry representative, arises, naturally enough, from the fact that the SROs are private concerns owned largely by the brokerage industry's member firms, among others. The resulting difficulty in enforcing, *e.g.*, the anti-churning aspect of the securities laws, apparently a burgeoning area of sales practice violations, is not lost on knowledgable observers of the industry and the SROs: "There's no doubt about the conflict facing the exchanges when they are supposed to discipline member firms. On the whole, the exchanges' records have been spotty." MONEY, Nov. 1985, at 226-236, 234 (quoting Norman Poser, Professor, Brooklyn Law School, former executive vice president of the American Stock Exchange ("AMEX"); Robert Shabazian, assistant vice president of AMEX ["Based upon our compliance department's investigations over the past three years, there has been an increase in churning." *Id.*]; Donald Malawsky, senior vice president of enforcement at the N.Y. Stock Exchange ["Unauthorized trading in customers' accounts is way up from five years ago." *Id.*]).

It is respectfully submitted that despite SEC oversight authority over the SROs, procedures generally at the SROs are simply inadequate to ensure that customers will get a fair review of their claims in arbitration. Concededly the SEC has selectively allocated its limited resources and manpower in this area. The executive director of the SEC, George G. Kundahl, in responding by letter dated July 11, 1986 to another GAO Report, *SEC Enforcement Program: Information on Productivity;*

Statements and Cases Closed Without Action, GAO/GGD-86-106BR (Aug. 26, 1986), stated the following concerning the manner in which the SEC narrowly executes its oversight authority:

> "In selecting matters for investigation, Commission managers *consider not only specific characteristics, such as the potential dollar value and number of investors involved*, but also intangible factors such as the deterrent value of a particular case."

Id. at Appendix IV, 21 (emphasis added).

This Court was similarly advised by the SEC as *Amicus Curiae* in *Bateman Eichler* that the SEC

> " 'does not have the resources to police the industry sufficiently to ensure that false tipping does not occur or is consistently discovered,' and that '[w]ithout the tippees' assistance, the Commission could not effectively prosecute false tipping — a difficult practice to detect.' "

Bateman Eichler v. Berner, *supra*, 105 S.Ct. at 2631, citing Brief for SEC as *Amicus Curiae* 25; H.R. Rep. No. 98-355, at 6 (1983) ("In recent years, the securities markets have grown dramatically in size and complexity, while Commission enforcement resources have declined.").[24]

This evidence warrants further inquiry into the bare assertion by the SEC as *Amicus Curiae* that, although the Commission will not vouch for procedures elsewhere, public investors as a whole are adequately protected in arbitral proceedings at the SROs. SEC as *Amicus Curiae* 13 *et seq*. If, by its own

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[24] *See* GAO Report, GAO/GGD-86-106BR, *supra*, App. IV at 21; *See also* H.R. Rep. 99-155, 99th Cong., 1st Sess. (1985) ("the SEC has limited resources and, understandably, must target its efforts on the largest, national threat to investor protection and market integrity.") *Id.* at 26 (Letter from President, North American Securities Administrators Assoc., Inc. to Hon. Timothy E. Wirth, Chairman, Subcommittee on Telecommunications, Consumer Protection and Finance).

admission to the accounting arm of the Congress, the SEC selectively "weeds out" those cases it deems too small or otherwise insignificant for its oversight,[25] a fair conclusion is that the thousands of public customers whose claims fall within this category are simply *not* protected by SEC oversight. The incontrovertible fact, unrebutted by petitioners in their brief on the merits and by their *Amici Curiae*, is that the SEC's oversight and regulatory authority over the SRO's, *per se*, is in actual practice, and considering the SEC's current budgetary constraints,[26] neither a guarantee of the fairness and adequacy of SRO arbitration procedures nor of procedures in other arbitral forums, such as the AAA, where the SEC exercises no authority.

Recently publicized revelations[27] about illegal insider trading and concomitant market manipulation, of which the Court is respectfully asked to take judicial notice, has heightened public awareness that all is not right with the financial marketplaces that deal with the public. Against this context, petitioners, and the SEC and SIA as *Amici Curiae*, argue generally, without any supporting evidence, that arbitral procedures for securities law claims are sound, either because of their outward indicia of uniformity and orderliness, or because of the Commission's general oversight authority, or a combination of the two. This

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[25] *See also* MONEY, *supra*, Nov. 1985, at 234: "But the SEC, by the admission of the New York office's [former] regional administrator, Ira Sorkin, has taken a less active role in prosecuting cases in the past two or three years. Instead, it refers most of them to the stock exchanges and broker-dealer associations because it doesn't have the staff to scrutinize millions of daily trades."

[26] H.R. Rep. 99-155, 99th Cong., 1st Sess., *supra* n.24, at 3 ("These and other events [of broker fraud and financial collapse of securities dealers, e.g.] have placed increased demands on the ability of the Commission, at its current funding and staffing levels, to protect investors and maintain the integrity of the nation's securities markets.").

[27] *See, e.g.*, N.Y. Times, Jan. 2, 1987, at B6, cols. 3-6; *id.*, Dec. 12, 1986, at A1, col. 1-D4, cols. 3-4; *SEC v. Boesky*, [Current] Fed.Sec.L.Rep. (CCH) ¶ 92,991, at 94,856 (S.D.N.Y. Nov. 14, 1986).

reasoning is flawed. It ignores the policy rationale advanced by the majority of the Circuit Courts of Appeals and fails to weigh meaningfully any considerations of congressional intent underlying the securities laws. As a transparent effort by the brokerage industry and its champions to shift the Court's focus away from the substance of policy to the form of procedure, petitioners' argument is ultimately unpersuasive.

D. The Fundamental Goals of the 1934 Act Are Impermissibly Undermined By Prospective Waivers of Its Statutorily Provided Rights

Just last term, Justice O'Connor, who delivered the opinion of the Court in *Randall v. Loftsgaarden*, revisited the legislative rationale underlying the protections with which public customers are vested under the 1934 Act:

> ". . . Congress' aim in enacting the 1934 Act was not confined solely to compensating defrauded investors. Congress intended to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions. *Affiliated Ute Citizens*, *supra*, at 151, 92 S.Ct. at 1471; *see also Hermann & MacLean*, 459 U.S., at 386-387, 103 S.Ct. at 1144-1145."

Randall v. Loftsgaarden, *supra*, ____ U.S. ____, 106 S.Ct. at 3154.

Consistent with these fundamental goals, the clear concern of the SEC, in addressing the pervasiveness of overreaching and manipulative practices in the securities industry in its dealings with public customers, has been the deterrence of fraud and ensuring the fullest possible disclosure. Thus, in 1979, the SEC acknowledged the self-same problem of non-disclosure and manipulation occurring at the time a customer opens an account that is at issue in the *McMahon* case:

> "It is the Commission's view that it is misleading to customers to require execution of any customer agreement which does not provide adequate disclosure

> about the meaning and effect of its terms, particularly any provision which might lead a customer to believe that he or she has waived prospectively rights under the federal securities laws . . . . Customers should be made aware prior to signing an agreement containing an arbitration clause that such a prior agreement does not bar a cause of action arising under the federal securities laws."

SEC Securities Exchange Act Release No. 15984, [1979 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶82,122, at 81,977-81,978 (July 2, 1979). *See also* SEC Securities Exchange Act Release No. 19813, [1982-83 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶83,356, at 85,967 n.6 (May 26, 1983).

Just three short years ago, the SEC enacted regulation 15c2-2, 17 C.F.R. Section 240.15c2-2, to correct the continuing industry-wide practice among brokers of failing to disclose to their public customers that, by signing a boiler-plate form of customer agreement containing an arbitration clause, the customer had not necessarily prospectively waived vested rights to a judicial forum under the federal securities laws. SEC Securities Exchange Act Release No. 20397, *supra*, [1983-84 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶83,452. Although the SEC, as *Amicus Curiae* 18, has not explicitly asserted in this case a repeal of Rule 15c2-2, its argument in support of a repeal of *Wilko* (SEC as *Amicus Curiae* 20) effectively undermines its earlier effort in support of full disclosure to public customers of their rights and against overreaching by brokers.

The obvious inconsistencies of this position render its premise, that full disclosure is now somehow obviated by oversight, untenable, especially since the SEC as *Amicus* readily concedes that "[t]his Court noted in *Mitsubishi Motors Corp.*, slip op. 12, that fraud and overreaching remain grounds for revoking an arbitration agreement." SEC as *Amicus Curiae* 19. But in *Mitsubishi*, the Court also stated that "the first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute," *Mitsubishi*, *supra*,

105 S.Ct. at 3354, and that "[o]f course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.' " *Id.* Clearly, petitioners' efforts to abridge or abrogate altogether public customers' statutorily provided rights to full disclosure, by seeking to enforce all prospective waivers of such rights, represent an unwarranted, intolerable departure from congressional intent and prior SEC releases, as interpreted by almost all the Circuit Courts of Appeals, and would also conflict with the plain meaning of *Mitsubishi*.

Nor may petitioners reasonably claim that the SEC's position is strictly a result of its previous understanding of the application by the courts of the *Wilko* rule to Section 10(b) claims. As early as 1951, in a release that pre-dates *Wilko*, the SEC censured the brokerage industry for the use of analogous clauses which, lacking adequate disclosure, were deemed patently inconsistent with "just and equitable principles of trade and may raise serious questions of compliance with the anti-fraud provisions of the federal securities laws," including the 1934 Act.[28]

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[28] SEC Securities Exchange Act Release No. 58 (Apr. 10, 1951), quoted in SEC Securities Exchange Act Release No. 19813, [1982-83 Transfer Binder] Fed.Sec.L.Rep (CCH) ¶83,356, 85,967 n.6:

> "This reasoning by the Commission was not novel. In 1951, the Commission released an opinion by its General Counsel concerning the use of 'hedge clauses' by brokers, dealers, investment advisers and others who sought thereby to avoid liability for a representation which they knew, or in the exercise of reasonable care could have discovered, to be false and misleading. The courts had repeatedly struck down such clauses. *See* Investment Advisers Act Release No. 58 (April 10, 1951). The position expressed in Release No. 58 was as follows:
>
> > 'All the statutes administered by the Commission provide that any condition, stipulation or provision which binds any person to waive compliance with their requirements shall
>
> *(Footnote continued)*

The SEC's obvious and sustained concern over three decades has been that public customers, such as respondents, would be induced to either submit to arbitration, uninformed of their vested rights to a judicial forum under the securities laws, or possibly not pursue their claims at all. SEC Exchange Act Release No. 15984, *supra*, [1979 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶82,122 at 81,978. Yet SEC endorsement of disclosure is linked to the limitations of oversight. In response to an inquiry by Chairman Dingell of the House Subcommittee on Oversight and Investigations, the SEC recently *conceded* its total *lack* of oversight authority over actual SRO arbitration proceedings: "The Commission has *no authority to review a specific arbitration to assure either compliance with the procedural requirements of the Code* [Uniform Code of Arbitration] *or accurate interpretations of underlying federal securities law* or other claims by the arbitrators."[29] Since SEC oversight authority does not police the actual day to day broker-customer relationship, the intent if not the letter of SEC regulations now in place, which promote full disclosure, should not be unnecessarily curtailed by the judiciary at a time when customers need more, not fewer, protections.

(Footnote continued)

> be void. . . .The question arises, therefore, whether the result, if not the purpose, of such a legend is to create in the mind of the investor a belief that he has given up legal rights and is foreclosed from a remedy which he might otherwise have. . .under the SEC statutes. . . .the antifraud provisions of the SEC statutes are violated by the employment of any. . .provision which is likely to lead an investor to believe that he has in any way waived any right of action he may have,. . . .[under] Section 10(b) of the Securities Exchange Act of 1934 and Rule [10b-5] thereunder, Section 15(c)(1) of that Act and Rule [15c1-2] thereunder. . . .' "

Id. at ¶83,356, 85,967 n.6.

[29] SEC Report of the Division of Market Regulation In Response to An Inquiry By the Honorable John D. Dingell, Chairman of the Committee on Energy and Commerce Concerning a Complaint by Joan Hunt Smith (August 28, 1986) (available from H.R. Committee on Energy & Commerce) (emphasis added).

Depriving public customers of a federal judicial forum as provided in the 1934 Act by Congress would only serve to undermine the public's confidence further. Respondents, who symbolically represent the cause of countless public customers in like circumstances, are in reality consumers in the securities marketplace, whose rights and protections only Congress has the authority to amend. The SEC as *Amicus* has itself affirmed the importance of the Section 10(b) remedy as a supplement to Commission action, and as an important weapon in the "arsenal of securities law protections." SEC as *Amicus Curiae* 26. In light of congressional intent and policy considerations underlying the regulatory scheme of the securities laws, respondents respectfully urge the Court to exercise its judgment and to find that, at least in this instance, the FAA must be accomodated in the context of the remedial federal securities laws, and that public customers shall not be compelled, despite a predispute waiver of the judicial forum, to arbitrate claims that arise under the 1934 Act.

II. Compelling Legislative History and Public Policies Preclude Arbitration of Civil RICO Claims

A. Congress Intended to Create an Exception to the FAA for Civil RICO Claims

That Congress intended to except civil RICO claims from the purview of the FAA is deducible from the statutory text. The grant by Congress to civil litigants of a private right of action and federal court jurisdiction of RICO claims is expressly provided in 18 U.S.C. Section 1964(c):

> "Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee."

By incorporating into the RICO statute the parallel jurisdictional and treble damage provisions of the analogous federal

antitrust laws, embodied principally in Section 4 of the Clayton Act, 15 U.S.C. Section 15, Congress was creating in effect a private attorney general provision, based upon the antitrust model, "in part designed to fill prosecutorial gaps." *Sedima, S.P.R.L. v. Imrex Co.*, ___ U.S. ___, 105 S.Ct. 3275, 3284 (1985).

Following the enactment of the RICO statute, numerous Circuit Courts, finding the antitrust analogy persuasive, have held arbitration of RICO claims to be unsuitable because of public policy concerns and statutory rights that cannot be adequately vindicated by the arbitration process.[30] *See, e.g., Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., supra* n.4, ___ F.2d ___, No. 86-1021 (1st Cir., Nov. 26, 1986), reprinted in [Current] Fed.Sec.L.Rep. (CCH) ¶93,001, 94,914-94,916 (all civil RICO claims not arbitrable); *Tashea v. Bache, Halsey, Stuart, Shields, Inc., supra* n.3, 802 F.2d 1337, 1339 (11th Cir. 1986) (per curiam) (civil RICO claims, predicated on violations of the securities laws, not arbitrable); *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., supra* n.3, 797 F.2d 1197, 1202 (3d Cir. 1986) (civil RICO claims, when predicated on nonarbitrable offenses, not arbitrable); *McMahon, supra* n.2, 788 F.2d at 97-98. *See also S.A. Mineracao da Trinidad-Samitri v. Utah International, Inc.*, 576 F.Supp. 566 (S.D.N.Y. 1983), *ordered certified for interlocutory appeal*, 579 F.Supp. 1049 (S.D.N.Y.), *appealed on other grounds and aff'd*, 745 F.2d 190 (2d Cir. 1984). *Contra Mayaja v. Bodkin, supra* n.3, 803 F.2d 157, 162 (5th Cir. 1986).

The Second Circuit in *McMahon* found the private attorney general model compelling and compared favorably the policy concerns shared in enforcement of both the RICO statute and the antitrust laws:

> "In other contexts, we have recognized the inappropriateness of the United States Arbitration Act when strong public policy considerations are involved.

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[30] *See also* Pet. App. F, subparagraph B, A46-A48.

> In *American Safety Equipment v. J.P. Maguire* 391 F.2d 821 (2 Cir. 1968), we stated that '[a] claim under the antitrust laws is not merely a private matter. The Sherman Act is designed to promote the national interest in a competitive economy; thus, the plaintiff asserting his rights under the Act has been likened to a private attorney-general who protects the public's interest.' 391 F.2d at 826. We hold that there are comparable concerns inherent in the enforcement of RICO claims.
>
> The Supreme Court has recognized that arbitration is appropriate in *international* antitrust disputes because of concerns for international comity, respect for the capacities of foreign and transnational tribunals, and the need for predictability in the international commercial system. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S.Ct. 3346 (1985). The reasoning of our decision in *American Safety*, however was not disputed in *Mitsubishi*, 'as applied to agreements to arbitrate arising from domestic transactions.' 105 S.Ct. at 3355. Enforcement of the RICO statute is particularly appropriate in a judicial forum because of strong policy concerns, the need for development of the record, and judicial clarification and resulting consistency in resolving disputes under this relatively new statute."

McMahon, supra, 788 F.2d at 98.

This Court's decision in the *Mitsubishi* case, which arose in the context of an international dispute, was not meant to nor does it emasculate the premise of the Second Circuit holding making unenforceable prospective agreements to arbitrate RICO claims in the context of domestic transactions. When this Court analyzed the private attorney general model and the legislative history of the Sherman and Clayton Acts in *Mitsubishi*, the "core" of that model, the "fundamental importance to American democratic capitalism of the regime of the antitrust laws," was

left intact. *Mitsubishi*, *supra*, 105 S.Ct. at 3358. Not only did the Court find that the private cause of action was central to the enforcement of the statutory scheme, but also that the "treble-damages provision. . . pos[es] a crucial deterrent to potential violators." *Id. Mitsubishi*, however, enforced an agreement to arbitrate an *international* antitrust dispute,[31] but did so "*even assuming a contrary result would be forthcoming in the domestic context.*" *Id.* at 3355 (emphasis added).

Similarly, in *Sedima* the Court found in the legislative history of RICO's private treble damages remedy clear legislative intent to apply the antitrust model adapted by RICO as a means to combat organized criminality, whether touching legitimate or illegitimate businesses. *Sedima*, *supra*, 105 S.Ct. at 3280-3281. Even more significantly, bearing on the question *sub judice* whether RICO claims are best adjudicated in a court of law, *Sedima* held that

> "... to the extent an action under §1964(c) might be considered quasi-criminal, requiring protections normally applicable only to criminal proceedings,. . . *the solution is to provide those protections*, not to ensure that they were previously afforded by requiring previous convictions."

Sedima, *supra*, 105 S.Ct. at 3283-3284 (citations omitted, emphasis added).

The Court's implicit acknowledgment in *Sedima* of the quasi-criminal nature of RICO's private civil remedy, and its reservations in the context of domestic transactions in *Mitsubishi*, were held recently by the First Circuit Court of Appeals to be compelling evidence that only courts may adjudicate RICO claims:

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[31] *Cf. Mitsubishi*, *supra*, 105 S.Ct. at 3365 ("The Court has repeatedly held that a decision by Congress to create a special statutory remedy renders a private agreement to arbitrate a federal statutory claim unenforceable.") (Stevens, J. dissenting).

> "*Mitsubishi*, in our estimation, allows for judicial inferences of an *implied Congressional intent to bar arbitration*, especially in light of express rights of action and in the context of a proceeding that involves adjudication of conduct subject to criminal as well as civil sanctions. *See* 18 U.S.C. §§ 1961(1), 1962, 1964(c). Second, we note that it is precisely our concern over the quasi-criminal nature of civil RICO proceedings (and hence, the need for exclusive Article III elaboration of standards of liability and procedural protections) that distinguishes our analysis from that of the Second Circuit in *McMahon*, *supra*. The Fifth Circuit's apparent solution to the problem — i.e., determining whether the particular action *sub judice* involves arguably criminal or organized crime activity — is in our view unsatisfactory. The makings of a 'pattern of racketeering activity' are not yet clear, but the fact remains that a 'pattern' for civil purposes is a 'pattern' for criminal purposes. 18 U.S.C. §§ 1961(1), 1962, 1964(c). This overlap, in our view, compels the inference that Congress intended only the courts, and not arbitrators, to decide the myraid [sic] of issues that will arise in determining the bounds of liability under the civil RICO statute."

Page v. Moseley, *supra*, ____ F.2d at ____ n.13, [Current] Fed.Sec.L.Rep. (CCH) ¶93,001 at 94,915-94,916 n.13.

A judicial inference of congressional intent to bar arbitration of RICO claims is thus warranted and wholly consistent with the statute's express, quasi-criminal remedy and grant of federal court jurisdiction.

B. Public Policy Considerations Bar the Arbitration of RICO Claims

The federal legislative policy underlying the civil RICO remedy can best be developed in the courts, where the private litigant has the procedural safeguards of judical fact-finding,

the rules of procedure and evidence that do not apply in the typical arbitration proceeding, the benefit of a complete record, additional safeguards of appellate review of RICO decisions, judicial expertise in interpreting and developing the law of a statutorily created cause of action, in this case embodied in a relatively new statute, and the deterrent effect of enforcing RICO by judicial injunction and decision to protect the public interest. Such a course has been set by the Court previously, despite the general federal policy favoring arbitration, and even in the absence of statutory antiwaiver provisions. *See generally McDonald v. City of West Branch, Michigan*, *supra* n.1, 466 U.S. 284; *Barrentine v. Arkansas-Best Freight System, Inc.*, *supra* n.1, 450 U.S. 728; *Alexander v. Gardner-Denver Co.*, *supra* n.1, 415 U.S. 36.

The importance of further interpreting and defining the parameters of this new law makes arbitration of RICO an unacceptable alternative forum. Arbitral panels are not trained in interpreting the complexities and ramifications of RICO, and lack the judicial mandate of issuing findings of fact and conclusions of law and following precedent. RICO thus cannot be fully and fairly evaluated and interpreted because appellate review of arbitration awards is virtually nonexistent. RICO defendants, however, will not be prejudiced by having their cases heard in court rather than in arbitration, since they will thereby be ensured of having their constitutional rights and privileges upheld and will have access to appellate review.

Both the remedial and deterrent function of civil RICO are deprecated by petitioners (Brief on the Merits at 46-49), who surmise that because the majority of RICO suits are merely "commercial disputes that otherwise would involve only claims of breach of contract, securities law violations, or fraud," *id.* at 47, arbitration is not inadequate to resolve such disputes "with no risk to any perceived public policy concerns." *Id.* at 48. This restrictive interpretation of RICO, however, is not supported by the Court's instruction in *Sedima* that RICO must be read and construed broadly "to effectuate its remedial purposes." *Sedima*, *supra*, 105 S.Ct. at 3286.

The importance to the public interest of enforcing RICO in the courts is made even more crucial *especially* where the underlying predicate acts consist of nonarbitrable violations of the securities laws, such as the churning claims at issue. *See, e.g., Tashea v. Bache, Halsey, Stuart, Shields, Inc., supra* n.3, 802 F.2d at 1338-1339. And it is unavailing to petitioners that the deterrent aspect of RICO might only operate concurrently with its private remedial feature, since Congress intended that the civil remedy should work in concert with the former to "enhance the effectiveness of [RICO's] prohibitions."[32]

The intent of Congress and valid public policy concerns advanced by the Second Circuit Court of Appeals are all consistent with the Court's holding in *Mitsubishi*, and justify the finding that agreements to arbitrate RICO claims are unenforceable.

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[32] Hearings on S.30, and Related Proposals, Before Subcommittee No. 5 of the House Committee on the Judiciary, 91st Cong., 2d Sess. 520 (1970).

CONCLUSION

Based upon all the foregoing reasons, the judgment of the United States Court of Appeals for the Second Circuit should be affirmed in all respects.

Dated: New York, New York
January 8, 1987

Respectfully submitted,

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No. 86-44

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONERS

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TABLE OF CONTENTS

	Page
Table of Authorities	ii
Argument	1
I. Congress Did Not Intend to Exempt § 10(b) Or RICO Claims From the Broad Mandate Of The United States Arbitration Act	3
II. Respondents Erroneously Rely on Prior Precedent of This Court In Arguing That § 10(b) and RICO Claims Are Exempt From The Arbitration Act	5
III. The Public Policy Arguments of Respondents Are Irrelevant and Misplaced	7
A. The Implied § 10(b) Right of Action Is Not Undermined by Acknowledging That Congress Did Not Intend to Prohibit Arbitration of Such a Claim	7
B. Congressional Hearings on Insider Trading Have No Bearing on the Adequacy of the Arbitral Forum	9
C. The Contractual Agreement of the Parties to Arbitrate Their Disputes Is Valid and Should Be Enforced	11
Conclusion	13

TABLE OF AUTHORITIES

Cases	Page
Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974)	3, 5, 6
Barrentine v. Arkansas-Best Freight System, Inc., 450 U.S. 728 (1981)	3, 5, 6
Coleman v. Prudential Bache Securities, Inc., 802 F.2d 1350 (11th Cir. 1986)	12
Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520 (9th Cir. 1986)	7
Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213 (1985)	7, 8
Finkle & Ross v. A. G. Becker Paribas, Inc., 622 F. Supp. 1505 (S.D.N.Y. 1985)	12
Ilan v. Shearson/American Express, Inc., 632 F. Supp. 886 (S.D.N.Y. 1985)	12
McDonald v. City of West Branch, Michigan, 466 U.S. 284 (1984)	3, 5, 6
McMahon v. Shearson/American Express, Inc., 618 F. Supp. 384 (S.D.N.Y. 1985), *aff'd in part, rev'd in part*, 788 F.2d 94 (2d Cir. 1986)	11
McMahon v. Shearson/American Express, Inc., 788 F.2d 94 (2d Cir. 1986)	11
Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 105 S. Ct. 3346 (1985)	2, 3, 12
Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 806 F.2d 291 (1st Cir. 1986)	7, 8

Page

Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 795 F.2d 1393 (8th Cir. 1986) 7

Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974) 3

Shearson Lehman Brothers, Inc. v. Lamers, No. B-86-507 (TFGD), Recommended Ruling on Motion to Dismiss (D. Conn. Jan. 20, 1987) ... 10

Wilko v. Swan, 346 U.S. 427 (1953) 4

Statutes and Regulations

Securities Act of 1933, Sec. 12(2), 15 U.S.C. § 77*l*(2) . 4

Securities Act of 1933, Sec. 14, 15 U.S.C. § 77n 4

Securities Exchange Act of 1934, Sec. 10(b), 15 U.S.C. § 78j(b) ..... *passim*

Securities Exchange Act of 1934, Sec. 29(a), 15 U.S.C. § 78cc(a) 4, 5, 7

Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.* ..... *passim*

United States Arbitration Act, 9 U.S.C. § 1 *et seq.* *passim*

Rule 10b-5, 17 C.F.R. § 240.10b-5 5

Article

Fletcher, *Privatizing Securities Disputes Through The Enforcement of Arbitration Agreements*, 71 Minn. L. Rev. 393 (1987) 8, 11

Legislative Material

Insider Trading in the Securities Markets, Hearings Before the H.R. Subcomm. on Oversight and Investigations of the H.R. Comm. on Energy and Commerce, 99th Cong., 2d Sess. (1986) 9

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ARGUMENT

Respondents rely in their Brief in Opposition on perceived public policy considerations for precluding arbitration of claims asserted under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.*, and argue that such disputes cannot be resolved adequately outside the judicial forum due to the unique aspects of federal court litigation and appellate practice. This argument fails to recognize that it is the role of Congress to weigh competing policies when it enacts legislation.

Congress enacted the United States Arbitration Act, 9 U.S.C. § 1 *et seq.*, fully aware of the differences between federal court litigation and arbitration. The Arbitration Act expresses congressional intent to enforce private agreements to arbitrate and to remove from congested courtrooms disputes that can be handled effectively in alternative forums. This Court has often recognized that the Arbitration Act creates a national policy favoring arbitration which is applicable equally to statutory, common law and other disputes. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346, 3355 (1985). Parties to arbitration agreements do not waive substantive rights, but only agree to a change of forum to enforce those rights. They simply contract to forego the judicial forum for the speed and finality of arbitration. The broad congressional policy underlying the Arbitration Act cannot be supplanted by an ad hoc judicial policy approach which effectively allows the judiciary to circumvent the Arbitration Act on a selective basis, and to elevate interests which Congress already has considered and subordinated to the national policy favoring arbitration. Regardless of judicial disagreement with this congressional policy, agreements to arbitrate statutory disputes must be enforced absent clear congressional intent to the contrary expressed in another statute or its legislative history.

The public policy arguments presented by respondents are not only irrelevant, they are misplaced. For example, a large part of the Brief in Opposition deals with current congressional hearings on insider trading abuses. Brief in Opposition ("Opp.") at 21-24, 29-34. These hearings provide no insight into the adequacy of the arbitral forum to resolve federal securities law disputes. Respondents also suggest that the Customer's Agreement they executed which contains an arbitration agreement is an unenforceable contract of adhesion. Opp. at 14 n.8. This issue is not before the Court, and respondents' suggestion is factually and legally inaccurate in any event. Finally, respondents express concern that the viability of the implied private § 10(b) action is somehow undermined by petitioners' contention that Congress could not have intended to prohibit arbitration of this judicially created right of action. Opp. at 16-18. Respondents

do not substantiate their concern, and offer no viable counter-argument to rebut the contention that Congress never intended to prohibit arbitration of claims asserted under § 10(b).

Additionally, respondents erroneously cite three cases for the proposition that this Court has balanced the Arbitration Act against various statutes and, in each case, refused to enforce an arbitration agreement in light of countervailing policy concerns in those statutes. Opp. at 7-8 & n.1 (citing *McDonald v. City of West Branch, Michigan*, 466 U.S. 284 (1984); *Barrentine v. Arkansas-Best Freight System, Inc.*, 450 U.S. 728 (1981); *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974)). None of these cases involved an analysis of the Arbitration Act, however, and each is distinguishable from the present case on other grounds as well.

I. Congress Did Not Intend to Exempt § 10(b) or RICO Claims From the Broad Mandate of The United States Arbitration Act.

The Arbitration Act expresses a strong congressional policy to enforce contractual agreements to arbitrate disputes. This Court often has recognized the broad mandate of the Arbitration Act and its applicability to statutory claims. *See Mitsubishi*, 105 S. Ct. at 3355; *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974). As the Court noted in *Mitsubishi*, the congressional policy favoring arbitration must be enforced by the courts absent contrary congressional intent evidenced in another statute:

> We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history.

Mitsubishi, 105 S. Ct. at 3355.

As demonstrated in Petitioners' Brief, there is no indication of any intention by Congress to prohibit arbitration of either

§ 10(b) or RICO claims expressed in either statute or its legislative history. *See* Petitioners' Brief at 14-33, 39-49. As evidence of congressional intent to prohibit arbitration of these claims, respondents and the circuit court below rely on the anti-waiver provision contained in § 29(a) of the Exchange Act, 15 U.S.C. § 78cc(a). That provision is virtually identical to § 14 of the Securities Act, 15 U.S.C. § 77n, which was interpreted by the Court in *Wilko v. Swan*, 346 U.S. 427 (1953), as a congressional prohibition of the enforcement of agreements to arbitrate claims asserted under § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2).

The *Wilko* Court interpreted an anti-waiver provision as prohibiting waiver of the judicial forum. This novel interpretation is not supported by the legislative history of either the Securities Act or the Exchange Act, 15 U.S.C. § 78a *et seq.*, and is at variance with the common law interpretation of such a provision as prohibiting waiver of substantive compliance with a statute. *See* Petitioners' Brief at 28-33. The Court's interpretation of an anti-waiver provision was based on its belief that arbitral forums were not capable of enforcing rights under the federal securities laws in 1953. *Wilko*, 346 U.S. at 435-37. This interpretation cannot be justified in light of the fair and efficient arbitral forums which exist today for the resolution of securities disputes, such as those authorized by Congress at the various self-regulatory organizations ("SROs") under the supervision of the Securities and Exchange Commission ("SEC"). *See* Petitioners' Brief at 28-39. The SEC, charged by Congress with the responsibility of interpreting and enforcing the federal securities laws, has reversed its position since *Wilko*, and now agrees with petitioners that securities arbitration at the SROs protects congressionally created statutory rights under the federal securities laws. *See* SEC Brief filed on behalf of petitioners as *amicus curiae*.

Even assuming its continued validity, *Wilko* clearly is limited to the unique and express § 12(2) cause of action, and should not be extended to § 10(b). *See* Petitioners' Brief at 19-28. The § 10(b) right of action was not created by Congress and is judicially implied. Furthermore, respondents brought suit

pursuant to Rule 10b-5, 17 C.F.R. § 240.10b-5, which was promulgated by the SEC under § 10(b) in furtherance of the enforcement and rulemaking powers conferred upon it by Congress. It is thus incorrect to conclude that Congress intended the anti-waiver provision in § 29(a) of the Exchange Act to apply to a right of action it never created, and to exempt it from the clear mandate of the Arbitration Act.

II. Respondents Erroneously Rely on Prior Precedent Of This Court In Arguing That § 10(b) and RICO Claims Are Exempt From The Arbitration Act.

Respondents cite a trilogy of Supreme Court cases in support of their contention that the policies underlying the Arbitration Act should be subordinated in this case. Opp. at 7-8 & n.1 (citing *McDonald v. City of West Branch, Michigan*, 466 U.S. 284 (1984); *Barrentine v. Arkansas-Best Freight System, Inc.*, 450 U.S. 728 (1981); *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974)). The statutes involved in these cases were the Civil Rights Act of 1871, 42 U.S.C. § 1983 (*McDonald*); the Fair Labor Standards Act, 29 U.S.C. § 201 *et seq.* (*Barrentine*); and Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e *et seq.* (*Alexander*). Respondents conclude that:

> This Court has often, in similar circumstances, sought to balance the mandate of the Federal Arbitration Act, 9 U.S.C. Section 1, *et seq.* ("FAA"), against its applicability in certain contexts of remedial, federal statutory legislation, and has in many cases, guided by legislative history and policy concerns, found the FAA inapplicable.

Opp. at 7-8 (footnote omitted).

In fact, none of these cases involved a balancing of the Arbitration Act against another statute. Not only did this Court not balance the underlying policies of the Arbitration Act against the underlying policies of the respective statutes at issue in

McDonald, *Barrentine*, and *Alexander*, the Court did not even mention the Arbitration Act in its analysis, as it was not in issue in any of these cases. All three cases dealt with the preclusive effect of a prior arbitration commenced pursuant to an arbitration clause contained in a collective bargaining agreement on a subsequent federal statutory action brought by an individual. *See McDonald*, 466 U.S. at 285-87; *Barrentine*, 450 U.S. at 729-30; *Alexander*, 415 U.S. at 38.[1] The Court in each case held that the prior arbitration proceeding did not preclude the subsequent federal action. Since the arbitration agreements in these cases specifically limited the power of the arbitrator to resolve contractual issues, the arbitrator was precluded from addressing statutory issues. Any award which addressed statutory issues would be subject to avoidance because the arbitrator exceeded his authority. *See McDonald*, 466 U.S. at 290-91; *Barrentine*, 450 U.S. at 744; *Alexander*, 415 U.S. at 53. In addition, the arbitration agreements involved in each case were negotiated by a union which did not necessarily represent the interests of the individual. *See McDonald*, 466 U.S. at 291; *Barrentine*, 450 U.S. at 742; *Alexander*, 415 U.S. at 51.

These issue preclusion cases are clearly distinguishable from the present case involving an arbitration agreement which does not restrict the arbitrator's authority and which was executed by individuals. Securities arbitrators, many of whom are attorneys, are empowered by the agreement executed by respondents to address all issues raised by the parties, statutory or otherwise, and are well-equipped to carry out the remedial purposes of the federal securities laws through the arbitral process. *See* Petitioners' Brief at 33-39; *see also Amici* Briefs filed by the SEC, the Securities Industry

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[1] In all three instances, the Court found two separate and distinct claims. One claim was based on a collective bargaining agreement, and the other claim was based on a statute. *See McDonald*, 466 U.S. at 288-90; *Barrentine*, 450 U.S. at 737-38, 745-46; *Alexander*, 415 U.S. at 48-51.

Association, Inc. ("SIA") and the American Arbitration Association ("AAA").[2]

III. The Public Policy Arguments of Respondents Are Irrelevant and Misplaced.

A. The Implied § 10(b) Right of Action Is Not Undermined by Acknowledging That Congress Did Not Intend to Prohibit Arbitration of Such A Claim.

Congress could not have intended the anti-waiver provision in § 29(a) of the Exchange Act to prohibit waiver of the judicial forum for the resolution of § 10(b) disputes since Congress did not create, or even consider creating, a private § 10(b) action. The § 10(b) right of action was judicially created by implication. *See* Petitioners' Brief at 24-26. Respondents label this argument as "superficial," yet offer no viable counterargument. *See* Opp. at 13. Rather, respondents reiterate at length that the existence of the implied § 10(b) action has been consistently recognized by this Court and is beyond doubt. Petitioners do not dispute this point. Respondents also suggest that petitioners' argument somehow undermines the § 10(b) action by the mere fact that it distinguishes § 10(b) from express causes of action under the federal securities laws. Opp. at 17-18. This, of course, is not the case. Petitioners' argument is advanced only in the context of examining congressional intent with respect to the arbitrability of an implied right of action. While the

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[2] Clearly the courts do not share respondents' concerns about the competency of arbitrators. Of the three courts of appeals that purported to rule on the arbitrability of § 10(b) claims free from the restraint of binding prior precedent since this Court's decision in *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985), two ruled that claims asserted under § 10(b) are arbitrable. *See Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc.*, 806 F.2d 291 (1st Cir. 1986); *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393 (8th Cir. 1986). *But see Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520 (9th Cir. 1986). However, even the *Conover* court did not base its decision on any supposed lack of competency on the part of securities arbitrators.

regulatory scheme of Congress permeates the federal securities laws, it simply cannot be argued that Congress ever intended to prohibit arbitration of an action it did not create. The undisputed fact is that Congress did not intend to create either judicial remedies or a judicial forum for judicially implied rights of action.

The contention that an anti-waiver provision cannot be construed to prohibit arbitration of the implied § 10(b) right of action has been adopted recently by the Court of Appeals for the First Circuit which ruled that agreements to arbitrate § 10(b) claims are enforceable:

> Because of the absence of any express "provision" for a judicial forum under [§ 10(b) of] the 1934 Act, we conclude that the 1934 Act's anti-waiver clause, by itself, does not suffice to indicate a Congressional intent to preclude arbitration.

Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 806 F.2d 291, 296 (1st Cir. 1986); *see also* Fletcher, *Privatizing Securities Disputes Through The Enforcement of Arbitration Agreements*, 71 Minn. L. Rev. 393, 402-04, 436-38 (1987). The distinction between an express and an implied cause of action is substantive when analyzing congressional intent. A Justice White articulated:

> *Wilko*'s solicitude for the federal cause of action—the "special right" established by Congress—is not necessarily appropriate where the cause of action is judicially implied and not so different from the common-law action.

Byrd, 470 U.S. at 225 (White, J. concurring) (citation omitted). There is no reason to ignore this analysis due to unfounded concerns that an implied right of action will be undermined.

B. Congressional Hearings on Insider Trading Have No Bearing on the Adequacy of the Arbitral Forum.

The adequacy of the arbitral forum to resolve securities disputes has been developed fully by petitioners in their Brief and by the Briefs filed by the SEC, the SIA and the AAA, as *amici curiae*, in support of petitioners.[3] Nonetheless, respondents question the ability of the SEC to oversee SRO arbitration adequately, pursuant to the mandate given the SEC by Congress in 1975. The concerns of respondents are premised on the current congressional investigation concerning market abuses such as stock manipulation and insider trading. *See Insider Trading in the Securities Markets, Hearings Before the H.R. Subcomm. on Oversight and Investigations of the H.R. Comm. on Energy and Commerce*, 99th Cong., 2d Sess. (1986). This congressional investigation does not concern the arbitration procedures at the various SROs:

> The hearing today is about just the kind of events which can destroy public trust and confidence. The questions we raise today about *insider trading* and *stock manipulation* will logically lead the Subcommittee in the coming year to look at corporate takeovers, leveraged buyouts, and the proper role of arbitrageurs.

Opp. at 21. (citing Opening Statement of Hon. John D. Dingell) (emphasis added).[4] Respondents' attempt to characterize

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[3] *See* Petitioners' Brief at 33-39, 46; SEC *Amicus Curiae* Brief at 13-21 (limited to § 10(b) claims); SIA *Amici Curiae* Brief at 5-11; AAA *Amicus Curiae* Brief at 12-19.

[4] Conspicuously absent from respondents' extensive quotations of the Opening Statement of the Chairman of the Subcommittee on Oversight and Investigations, is his praise of the SEC's recent oversight enforcement in this area. The Chairman stated: "On behalf of the Subcommittee, I want to applaud the efforts of the SEC enforcement staff in putting the Levine and Boesky [insider trading] cases together. They have worked long and hard, and justly deserve credit." *Insider Trading in the Securities Markets, Hearings before the H.R. Subcomm. on Oversight and Investigations of the H.R. Comm. on Energy and Commerce*, 99th Cong., 2d Sess. (1986) (Opening Statement of Hon. John D. Dingell).

congressional inquiries into insider trading and market manipulation as casting doubt over "[t]he adequacy of the arbitral forum to vindicate [statutory] rights" cannot be substantiated. *See* Opp. at 5.[5]

In the final analysis, the issue is not whether the SEC oversees SRO arbitration since nothing in the Arbitration Act requires such oversight. The AAA, like the SROs, also provides a fair and efficient forum for the resolution of securities disputes notwithstanding the absence of SEC jurisdiction. *See* AAA *Amicus Curiae* Brief submitted on behalf of petitioners. The issue remains whether Congress intended to allow federal securities law claims to be heard in an arbitral forum and whether securities arbitration is competent, efficient and impartial. Respondents offer no compelling evidence to challenge the competency, efficiency or fairness of securities arbitration in the United States.[6]

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[5] *See also* Opp. at 29-34. Without supporting authority, respondents imply that any deficiency of SEC oversight in this area applies to SRO arbitration. As more fully discussed in Petitioners' Brief and the *amici* briefs filed in support of petitioners, the SEC has found the Uniform Code of Arbitration, which governs SRO arbitration, "to be in the public interest and in furtherance of just and equitable principles of trade." Additionally, the SEC retains jurisdiction to correct perceived abuses or unfairness in the Arbitration Rules and is required to approve and has approved any SRO rule changes since 1975. *See* Petitioners' Brief at 33-39. There is simply no evidence that SEC oversight is lacking in the area of SRO arbitration.

[6] Respondents suggest to this Court in their Brief in Opposition that Shearson has claimed in another pending action that SRO arbitration is inherently unfair. Opp. at 25-26. This gross mischaracterization was rejected recently by the Magistrate who recognized that Shearson opposes arbitration in that case because plaintiffs were not customers of Shearson, and had no arbitration agreement with Shearson. Furthermore, the disputed transactions involved private notes not purchased or sold through Shearson on any securities exchange. The Magistrate found that "*McMahon* is entirely distinguishable." *See Shearson Lehman Brothers, Inc. v. Lamers*, No. B-86-507 (TFGD), Recommended Ruling on Motion to Dismiss (D. Conn. Jan. 20, 1987) at n.6.

C. The Contractual Agreement of the Parties to Arbitrate Their Disputes Is Valid and Should Be Enforced.

While respondents concede that they executed the arbitration agreement voluntarily, they nonetheless suggest, without foundation, that the agreement is contained in an unenforceable contract of adhesion. Opp. at 14 n.8. The district court dismissed this argument as "wholly unconvincing" and held that respondents failed to set forth any facts which demonstrated fraud or duress by petitioners or lack of bargaining power on the part of respondents.[7] Respondents never alleged that they attempted to negotiate the agreement in any way. The Court should not review this factual determination by the district court especially in light of respondents' failure to raise the contract of adhesion issue before the court of appeals, which found "no reason to disturb the district court's threshold [factual] determination that an enforceable arbitration clause was in effect." *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94, 96 n.6 (2d Cir. 1986).

Nonetheless, it should be noted that a customer does not have to sign an arbitration agreement to engage in securities transactions. A recent survey of four of the largest national brokerage firms reveals that customers can open a cash account at three of these firms without entering into an arbitration agreement. Although margin agreements are required at all four firms, only two of these agreements contain arbitration clauses. *See* Fletcher, *Privatizing Securities Disputes Through The Enforcement of Arbitration Agreements*, 71 Minn. L. Rev. at 445-48. Since a customer does have bargaining power, an arbitration agreement contained in a Customer's Agreement is not an adhesion contract.

In addition, even an adhesion contract will be enforced unless its terms are unduly oppressive, unconscionable or against public

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[7] *See McMahon v. Shearson/American Express, Inc.*, 618 F. Supp. 384, 386 (S.D.N.Y. 1985) ("Arbitration clauses are routinely upheld by the courts, and, given [respondents'] sizeable investment, there is nothing to indicate that they were without bargaining power."), *aff'd in part, rev'd in part on other grounds*, 788 F.2d 94 (2d Cir. 1986).

policy. *See Ilan v. Shearson/American Express, Inc.*, 632 F. Supp. 886, 891 (S.D.N.Y. 1985); *Finkle & Ross v. A.G. Becker Paribas, Inc.*, 622 F. Supp. 1505, 1511-12 (S.D.N.Y. 1985). An arbitration agreement contained in a Customer's Agreement cannot be characterized as unconscionable or contrary to public policy since there exists a strong national policy favoring arbitration. *See Mitsubishi*, 105 S. Ct. at 3353-54; *Finkle & Ross*, 622 F. Supp. at 1512; *Ilan*, 632 F. Supp. at 891; *see also Coleman v. Prudential Bache Securities, Inc.*, 802 F.2d 1350, 1352 (11th Cir. 1986) ("there is nothing inherently unfair or oppressive about arbitration clauses").

CONCLUSION

Based on the reasons contained in Petitioners' Reply Brief, as well as those in their Brief on the merits, the judgment of the United States Court of Appeals for the Second Circuit should be reversed insofar as it refused to enforce the contractual agreement of the parties to arbitrate claims asserted under § 10(b) of the Exchange Act and RICO.

Dated: New York, New York
February 20, 1987

Respectfully submitted,

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No. 86-44

In the Supreme Court of the United States

OCTOBER TERM, 1986

Supreme Court, U.S.
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SHEARSON/AMERICAN EXPRESS, INC.
AND MARY ANN MCNULTY, PETITIONERS

v.

EUGENE MCMAHON, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE SUPPORTING PETITIONERS

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QUESTION PRESENTED

Whether a federal district court is barred from enforcing agreements to arbitrate claims arising out of contractual relationships if those claims assert an implied right of action under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b).

TABLE OF CONTENTS

	Page
Interest of the Securities and Exchange Commission	1
Statement	3
Summary of argument	5
Argument:	
The antiwaiver provisions of the federal securities laws do not preclude enforcement of predispute agreements between brokerage firms and their customers to arbitrate disputes under arbitration procedures prescribed by self-regulatory organizations subject to the regulatory authority of the Securities and Exchange Commission	8
A. *Wilko* v. *Swan* held the arbitration agreement there in issue unenforceable because the Court deemed arbitration, under the circumstances of that case, inadequate to enforce compliance with substantive duties under the securities laws	9
B. Arbitration subject to the Commission's post-1975 regulatory authority is adequate to enforce substantive duties under the securities laws	13
C. The distinction between express and implied rights of action, and technical distinctions between the 1933 and 1934 Acts, are irrelevant to the decision in this case	21
Conclusion	27

TABLE OF AUTHORITIES

Cases:

AFP Imaging Corp. v. *Ross*, 780 F.2d 202, cert. denied, No. 85-1805 (June 30, 1986)	4
Allegaert v. *Perot*, 548 F.2d 432, cert. denied, 432 U.S. 910	4
Ayres v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, cert. denied, 429 U.S. 1010	18-19
Bateman Eichler, Hill Richards, Inc. v. *Berner*, No. 84-679 (June 11, 1985)	25, 26
Blue Chip Stamps v. *Manor Drug Stores*, 421 U.S. 723	26
Colonial Realty Corp. v. *Bache & Co.*, 358 F.2d 178, cert. denied, 385 U.S. 817	5

Cases—Continued: Page

Conover v. *Dean Witter Reynolds, Inc.*, 794 F.2d 520, petition for cert. pending, No. 86-321 ..... 5, 18
Dean Witter Reynolds, Inc. v. *Byrd*, 470 U.S. 213 ..... 4, 5, 10, 13, 21, 22
Ernst & Ernst v. *Hochfelder*, 425 U.S. 185 23
Greater Continental Corp. v. *Schecter*, 422 F.2d 1100 4-5
Herman & MacLean v. *Huddleston*, 459 U.S. 375 .....15, 23, 24, 25, 26
J.I. Case Co. v. *Borak*, 377 U.S. 426 26
Jacobson v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197 5
King v. *Drexel Burnham Lambert, Inc.*, 796 F.2d 59, petition for cert. pending, No. 86-282 5
Lorillard v. *Pons*, 434 U.S. 575 25
Mansbach v. *Prescott, Ball & Turben*, 598 F.2d 1017 5
Merrill Lynch, Pierce, Fenner & Smith, Inc. v. *Curran*, 456 U.S. 353 25
Merrill Lynch, Pierce, Fenner & Smith, Inc. v. *Moore*, 590 F.2d 823 5
Merrill Lynch, Pierce, Fenner & Smith, Inc. v. *Ware*, 414 U.S. 117 11
Mitsubishi Motors Corp. v. *Soler Chrysler-Plymouth, Inc.*, No. 83-1569 (July 2, 1985) 3, 5-6, 8, 13, 14, 19
Moses H. Cone Memorial Hospital v. *Mercury Construction Corp.*, 460 U.S. 1 8
Phillips v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, petition for cert. pending, No. 86-578 .. 5, 19, 22
Scherk v. *Alberto-Culver Co.*, 417 U.S. 506 ..... 5, 10, 13, 19, 21, 22
Southland Corp. v. *Keating*, 465 U.S. 1 ..... 8, 13
Touche Ross & Co. v. *Redington*, 442 U.S. 560 25
Weissbuch v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831 ..... 5, 18
Wilko v. *Swan*:
346 U.S. 427 ..... *passim*
201 F.2d 439 20
Wolfe v. *E.F. Hutton & Co.*, 800 F.2d 1032 .....5, 18, 25

Constitution, statutes, regulations and rules: Page

New York Stock Exchange, Inc. Const., art. XI, 2 N.Y.S.E. Guide (CCH) ¶¶ 1501-1503 (1984) 17

Federal Arbitration Act, 9 U.S.C. 1 *et seq.* 5
§ 2, 9 U.S.C. 2 3
§ 9 U.S.C. 3 ..... 4, 10

Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. (& Supp. II) 1961 *et seq.* 1
18 U.S.C. 1962(c) 4

Securities Act of 1933, 15 U.S.C. (& Supp. II) 77 *et seq.*:
§ 11, 15 U.S.C. 77k 25
§ 11(e), 15 U.S.C. 77k(e) 23
§ 12(2), 15 U.S.C. 77*l*(2) 4, 6, 7, 10, 11, 20, 22, 23, 24
§ 13, 15 U.S.C. 77m 23
§ 14, 15 U.S.C. 77n 6, 9, 10, 11, 12, 21, 22, 24
§ 22, 15 U.S.C. 77v 22, 23
§ 22(a), 15 U.S.C. 77v(a) 10, 23

Securities Exchange Act of 1934, 15 U.S.C. (& Supp. II) 78 *et seq.*:
§ 6, 15 U.S.C. 78f 14
§ 10(b), 15 U.S.C. 78j(b) ..... *passim*
§ 15(b)(8), 15 U.S.C. (Supp. II) 78*o*(b)(8) 14
§ 15A, 15 U.S.C. 78*o*-3 (52 Stat. 1070) 14, 15
§ 15A(j), 15 U.S.C. (1964 ed.) 78*o*-3(j) 15
§ 15A(k)(1), 15 U.S.C. (1964 ed.) 78*o*-3(k)(1) 15
§ 15A(k)(2), 15 U.S.C. (1964 ed.) 78*o*-3(k)(2) 15
§ 15B(b)(2)(D), 15 U.S.C. 78*o*-4(b)(2)(D) 19
§ 19, 15 U.S.C. 78s 2, 7, 13, 14, 20
§ 19(b), 15 U.S.C. 78s(b) (48 Stat. 898) 15, 16, 17
§ 19(b)(1), 15 U.S.C. 78s(b)(1) 16
§ 19(b)(2), 15 U.S.C. 78s(b)(2) 16
§ 19(c), 15 U.S.C. 78s(c) 16
§ 27, 15 U.S.C 78aa 22, 23
§ 28, 15 U.S.C. 78bb 19
§ 29, 15 U.S.C. 78cc 9, 10, 19, 22, 24
§ 29(a), 15 U.S.C. 78cc(a) 6, 9, 12

Pub. L. No. 94-29, § 16, 89 Stat. 146 16

Constitution, statutes, regulations and rules—Continued: Page

17 C.F.R.:
Section 240.10b-5 ..... 1, 2, 4, 6, 9, 18, 24, 25, 26
Section 240.15c2-2 18
Section 240.19b-4 17

Arbitration Rules of the American Stock Exchange, Inc., 2 Am. Stock Ex. Guide (CCH) ¶¶ 9540-9551J (1984) .. 17

2 N.Y.S.E. Guide (CCH) ¶¶ 2600-2634, Rules 600-634 (1984) 17

Miscellaneous:

ALI, *Study of the Division of Jurisdiction Between State and Federal Courts* (1969) 23

Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., N.A.S.D. Man. (CCH) ¶¶ 3701-3743 (1986) 17

H.R. Rep. 94-229, 94th Cong., 1st Sess. (1975) 19

Katsoris, *The Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279 (1984) 17

Note, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 Duke L.J. 548 23

Note, *The Securities Exchange Act and the Rule of Exclusive Federal Jurisdiction*, 89 Yale L.J. 95 (1979) 23

S. Rep. 94-75, 94th Cong., 1st Sess. (1975) 14, 16

Securities Acts Amendments of 1975: Hearings on S. 249 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess. (1975) 15

Securities Exchange Act Release No. 20397, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,452 (Nov. 18, 1983) 18

Securities Exchange Act Release No. 16390 (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979) 17

Securities Exchange Act Release No. 15984, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,122 (July 2, 1979) 18

Securities Exchange Act Release No. 13470, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,136 (Apr. 26,1977) 17

In the Supreme Court of the United States

OCTOBER TERM, 1986

No. 86-44

SHEARSON/AMERICAN EXPRESS, INC. AND MARY ANN MCNULTY, PETITIONERS

v.

EUGENE MCMAHON, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE SUPPORTING PETITIONERS

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

This case raises two questions concerning the enforceability of predispute arbitration agreements between brokerage firms and their customers. The first question is whether a claim under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act or 1934 Act), 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, must be referred to arbitration in accordance with a predispute arbitration agreement. The second question is whether a claim under the RICO statute, 18 U.S.C. (& Supp. II) 1961 *et seq.*, must be referred to arbitration in accordance with such an agreement.

The Securities and Exchange Commission submits this brief to address the first of those questions. The Commission is the agency principally responsible for the administration and enforcement of the federal securities laws and regulations, including Section 10(b) and Rule 10b-5.

The Commission is responsible for overseeing and regulating the activities of stock exchanges and securities associations, including the rules they prescribe for arbitration of claims against their members, such as petitioner Shearson/American Express, Inc., in this case.

The Commission has two specific interests in the resolution of this case. First, the Commission urges the Court to limit its analysis to a narrower question than the broad question framed by the petition. The arbitration procedures specified in the agreement at issue here, between a broker-dealer and its customers, are subject to the Commission's broad oversight authority under Section 19 of the Exchange Act (15 U.S.C. 78s), which is sufficient to ensure that arbitration procedures are adequate to enforce statutory rights of customers against broker-dealers. The Commission believes that arbitration agreements specifying procedures subject to such oversight are enforceable and urges the Court to avoid addressing other circumstances, where, in contrast to this case, the Commission lacks oversight authority.

Second, the Commission urges the Court not to rely on a distinction between express and implied rights of action in resolving the question presented in this case. As we show below, that distinction should make no difference in determining the enforceability of an arbitration agreement. The implied right of action under Section 10(b) and Rule 10b-5 is as deserving of a hearing in a proper forum, and as necessary to effectuate the policies of the securities laws, as the various express rights of action. The Commission believes that it is important for the Court to avoid the contrary suggestion that might be thought implicit in a decision based on a distinction between express and implied rights of action.[1]

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[1] The Commission here addresses only the question whether the arbitration agreement is rendered unenforceable by virtue of the fact that the claim arose under the federal securities laws. We do not ad-

STATEMENT

Between 1980 and 1982, respondents Eugene and Julia McMahon, either individually or on behalf of various trusts, became customers of petitioner Shearson/American Express, Inc. (Shearson), a brokerage firm registered with the Securities and Exchange Commission (Pet. App. A9, A20). Their agreement with Shearson provided for arbitration of any controversy relating to the account pursuant to the rules of a securities industry self-regulatory organization (SRO) to which Shearson belonged (*ibid.*). The agreement provided (*id.* at A9):

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I may elect.

In 1984, respondents filed a complaint in the United States District Court for the Southern District of New York against Shearson and Mary Ann McNulty, the registered representative who handled their accounts. The

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dress other grounds for challenging such agreements. We note, in this regard, this Court's recent reminder that "courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.' " *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, No. 83-1569 (July 2, 1985), slip op. 12 (quoting 9 U.S.C. 2). See also *Wilko* v. *Swan*, 346 U.S. 427, 440 (1953) (Frankfurter, J., dissenting) (distinguishing situation where customer "had no choice but to accept the arbitration stipulation, thereby making the stipulation an unconscionable and unenforceable provision").

complaint alleged that petitioner McNulty, with the knowledge of Shearson, engaged in fraudulent, excessive, and inappropriate trading on their accounts and made false statements and omitted material facts in giving advice to respondents. The complaint alleged violations of, and sought relief under, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. 1962(c), and under state law rules governing fraud and breach of fiduciary duty (Pet. App. A9, A20-A21).

Petitioners, relying on the signed arbitration agreement, moved to compel arbitration of all of respondents' claims pursuant to Section 3 of the Federal Arbitration Act, 9 U.S.C. 3. The district court granted the motion in part. The court first rejected respondents' argument that the arbitration provision was not enforceable because the customer agreement was a contract of adhesion (Pet. App. A22). The court then held that the state law claims were arbitrable under *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. 213 (1985), and that the RICO claims were not arbitrable because of the strong federal policies inherent in the enforcement of RICO (Pet. App. A23). Finally, the district court held that the claims under Section 10(b) and Rule 10b-5 were arbitrable (Pet. App. A25).

The court of appeals affirmed on the RICO and state-law claims (Pet. App. A15-A17) but reversed on the securities law claims (*id.* at A10-A15). With regard to the latter, the court observed that the Second Circuit had long denied compulsory arbitration to claims under Section 10(b) and Rule 10b-5 by extending to them the rule of *Wilko* v. *Swan*, 346 U.S. 427 (1953), that a claim under Section 12(2) of the Securities Act of 1933 (Securities Act or 1933 Act), 15 U.S.C. 77*l*(2), was not subject to compulsory arbitration (Pet. App. A10-A12).[2] The court

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[2] See *AFP Imaging Corp.* v. *Ross*, 780 F.2d 202, 205 (2d Cir. 1985), cert. denied, No. 85-1805 (June 30, 1986); *Allegaert* v. *Perot*, 548 F.2d 432, 437-448 (2d Cir.), cert. denied, 432 U.S. 910 (1977); *Greater Con-*

noted, however, that this Court and its members had on occasion cast doubt on the applicability of *Wilko* v. *Swan, supra*, to claims under the Exchange Act (Pet. App. A12-A14). See *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. 213, 215-216 & n. 1 (1985); *id.* at 224-225 (White, J., concurring); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 513-514 (1974). Nevertheless, the court of appeals deemed it improvident to depart from its own "settled law" and therefore held that the *Wilko* rationale was applicable to claims under the Exchange Act (Pet. App. A14-A15).[3]

SUMMARY OF ARGUMENT

The starting point for analysis of this case is the Federal Arbitration Act, 9 U.S.C. 1 *et seq.*, which provides for the enforcement of a contract to arbitrate as if it were any other contract. As this Court explained in *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, No.

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tinental Corp. v. *Schechter*, 422 F.2d 1100, 1103 (2d Cir. 1970); *Colonial Realty Corp.* v. *Bache & Co.*, 358 F.2d 178, 183 n.5 (2d Cir.), cert. denied, 385 U.S. 817 (1966).

[3] Seven courts of appeals other than the Second Circuit have held that Section 10(b) claims are not subject to compulsory arbitration. See, *e.g.*, *Wolfe* v. *E.F. Hutton & Co.*, 800 F.2d 1032 (11th Cir. 1986) (en banc); *Jacobson* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197 (3d Cir. 1986); *King* v. *Drexel Burnham Lambert, Inc.*, 796 F.2d 59 (5th Cir. 1986), petition for cert. pending, No. 86-282; *Conover* v. *Dean Witter Reynolds, Inc.*, 794 F.2d 520 (9th Cir. 1986), petition for cert. pending, No. 86-321; *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1030 (6th Cir. 1979); *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, v. *Moore*, 590 F.2d 823, 827-829 (10th Cir. 1978); *Weissbuch* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831, 833-835 (7th Cir. 1977).

In *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, 1397-1398 (1986), petition for cert. pending, No. 86-578, the Eighth Circuit reached a contrary result, concluding that *Wilko* did not extend to Section 10(b) claims.

83-1569 (July 2, 1985), the command of the Federal Arbitration Act applies to arbitration of statutory claims as well as contract claims. A predispute arbitration agreement covering a statutory claim is unenforceable only if the statute giving rise to the claim reflects a congressional intent to limit or prohibit waiver of the right to bring the claim to court.

In *Wilko* v. *Swan*, 346 U.S. 427 (1953), this Court held that a predispute arbitration agreement could not be enforced to compel arbitration of a claim arising under Section 12(2) of the Securities Act, 15 U.S.C. 77*l*(2). The basis for this ruling was that Section 14 of the Securities Act, 15 U.S.C. 77n, declares void any agreement to waive "compliance with any provision" of the 1933 Act. The Court concluded that arbitration was inadequate to protect the investor rights under Section 12(2).

In the present case, suit was brought against a broker-dealer under Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5. The right of action under Section 10(b) and Rule 10b-5 is as important as the right of action under Section 12(2) of the 1933 Act, and Section 29(a) of the Exchange Act, 15 U.S.C. 78cc(a), like Section 14 of the 1933 Act, declares void any agreement to waive "compliance with any provision" of the 1934 Act. But under the circumstances of this case, respondents' agreement to submit to arbitration was not a waiver of petitioners' compliance with any provision of the 1934 Act, because arbitration is adequate to enforce petitioners' duties.

There are two related grounds of distinction between *Wilko* and the present case. First, since 1953 this Court has rejected the suspicion of arbitration on which *Wilko* was based. Second, since 1975 the Securities and Exchange Commission has had extensive authority to oversee and to regulate the arbitration procedures prescribed by stock exchanges and other self-regulatory organizations for use by

members (such as petitioner Shearson) in disputes with their customers. See Section 19 of the Exchange Act, 15 U.S.C. 78s. This regulatory authority, as its exercise to date demonstrates, can ensure that such arbitration procedures are adequate to protect statutory rights. Accordingly, there is no reason to treat a predispute agreement to arbitrate in accordance with such procedures as a prohibited waiver of compliance with any provision of the securities laws.

In holding the agreement in this case enforceable, the Court should limit its analysis to predispute arbitration agreements between brokerage firms and their customers that prescribe procedures that are subject to the Commission's oversight authority. The Commission takes no position on the enforceability of other predispute arbitration agreements. The Commission urges the Court that it is not necessary to decide here whether there are sufficient guarantees of the adequacy of arbitration in situations beyond the oversight power of the Commission.

The Commission further urges the Court not to rely, in deciding this case, on any supposed distinction between express rights of action, such as the one at issue in *Wilko* (under Section 12(2) of the Securities Act), and implied rights of action, such as the one at issue here (under Section 10(b) of the Exchange Act). Both kinds of rights are important, and no such distinction is relevant to determining whether arbitration is adequate to protect statutory rights and hence whether an agreement to arbitrate constitutes a waiver of compliance with any provision of the securities laws. Invocation of any such distinction, moreover, might be misconstrued to suggest a lesser importance or stature for implied rights of action, which would be contrary to this Court's decisions and destructive of investor protections under the securities laws.

ARGUMENT

THE ANTIWAIVER PROVISIONS OF THE FEDERAL SECURITIES LAWS DO NOT PRECLUDE ENFORCEMENT OF PREDISPUTE AGREEMENTS BETWEEN BROKERAGE FIRMS AND THEIR CUSTOMERS TO ARBITRATE DISPUTES UNDER ARBITRATION PROCEDURES PRESCRIBED BY SELF-REGULATORY ORGANIZATIONS SUBJECT TO THE REGULATORY AUTHORITY OF THE SECURITIES AND EXCHANGE COMMISSION

The Federal Arbitration Act, as construed by this Court, is the starting point for answering the question presented in this case. The Federal Arbitration Act creates "a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate * * *." *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. 1, 25 n.32 (1983). The Act establishes a "federal policy favoring arbitration" (*id.* at 24). See also *Southland Corp.* v. *Keating*, 465 U.S. 1, 10 (1984). As this Court has recently noted, "there is no reason to depart from" the policy favoring arbitration "where a party bound by an arbitration agreement raises claims founded on statutory rights" (*Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, No. 83-1569 (July 2, 1985), slip op. 11). Thus, the Federal Arbitration Act, standing alone, would require the enforcement of an agreement to arbitrate statutory claims (*id.* at 12-13).

This statutory directive, like any other, may be overridden by a contrary legislative command. This Court has accordingly held that an agreement to arbitrate a statutory claim is not to be enforced if Congress has manifested an intent to protect against waiver of the right to a judicial forum for the particular claim (*Mitsubishi Motors Corp.*, slip op. 12-13). The opponent of arbitration, however, must overcome the presumption of enforceability of the agreement under the Federal Arbitration Act. "Having

made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue" (slip op. 13).

The question in this case is whether Congress has expressed an intent to preclude waiver of a customer's right to bring suit against a broker-dealer under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The asserted basis for finding such an intent is Section 29(a) of the Exchange Act, 15 U.S.C. 78cc(a), which declares void "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of [the Act]." That provision, by its own terms, would bar enforcement of an arbitration agreement only if the agreement to accept a nonjudicial forum effected a waiver of the other party's duty to comply with the Exchange Act. Where, as in the present case, the Commission has sufficient statutory authority to ensure the adequacy of arbitration as a means of enforcing duties under the Exchange Act, there is no reason to conclude that an agreement to arbitrate constitutes such a waiver: under these circumstances, arbitration is adequate to vindicate Exchange Act rights, and therefore there can be no waiver of "compliance with any provision" of the Act.

A. *Wilko* v. *Swan* Held The Arbitration Agreement There In Issue Unenforceable Because The Court Deemed Arbitration, Under The Circumstances Of That Case, Inadequate To Enforce Compliance With Substantive Duties Under The Securities Laws

In *Wilko* v. *Swan*, 346 U.S. 427 (1953), this Court considered whether the antiwaiver provision of Section 14 of the 1933 Act, 15 U.S.C. 77n, which is essentially identical to Section 29(a) of the Exchange Act,[4] precluded the en-

[4] Section 14 provides:

> Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of

forcement of a predispute arbitration agreement. The plaintiff brought an action for damages under Section 12(2) of the Securities Act, 15 U.S.C. 77*l*(2). The defendant, relying on a predispute arbitration agreement, moved to stay the action and compel arbitration pursuant to Section 3 of the Federal Arbitration Act, 9 U.S.C. 3. This Court held that enforcement of the arbitration agreement would be contrary to Section 14 of the 1933 Act.

The Court said that Section 22(a) of the 1933 Act, 15 U.S.C. 77v(a), which permits suit to be brought in federal or state court, "is the kind of 'provision' that cannot be waived under § 14 of the Securities Act" (346 U.S. at 435). This "semantic reasoning" (*Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 513), however, was only the beginning of the Court's analysis. Most of the Court's opinion concerns the perceived inadequacy of arbitration as a substitute for adjudication (346 U.S. at 435-438). Although the *Wilko* opinion is, we acknowledge, not entirely clear on this point, we think the case must be read as holding that a waiver of the "right to select the judicial forum" (*id.* at 435) is unenforceable only because arbitration was judged inadequate to enforce the statutory duties created by Section 12(2).

The statutory language itself strongly suggests this reading of *Wilko*. What is prohibited by Section 14 is enforcement of waivers of "compliance with any provision" of the 1933 Act or regulations. But Section 22(a) does not itself impose on sellers of securities, like the defendant in *Wilko*, any duty with which they must "comply." *Wilko*

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this subchapter or of the rules and regulations of the Commission shall be void.

This Court has viewed Section 14 of the 1933 Act and Section 29 of the 1934 Act as identical for all relevant purposes. See *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 514 n.7 (1974). See also *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. at 224-225 (White, J., concurring).

makes sense under the language of Section 14 only to the extent it was based on the judgment that a judicial forum was needed to protect the substantive rights at issue—that is, the rights under Section 12(2).[5]

In fact, the opinion in *Wilko* is principally concerned with explaining why arbitration is not an adequate substitute for adjudication as a means of enforcing "the provisions of the Securities Act, advantageous to the buyer" (346 U.S. at 435). The Court introduces this explanation by saying that the "effectiveness [of the Act's provisions] in application is lessened in arbitration as compared to judicial proceedings" (*ibid.*). The Court concludes the discussion by expressly giving the inadequacy of arbitration as the reason for its conclusion: "As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended § 14 * * * to apply to waiver of judicial trial and review" (*id.* at 437 (footnote omitted)). The *Wilko* opinion itself thus expressly bases its decision on the conclusion that arbitration is inadequate to enforce substantive rights.

There was no evidence cited in *Wilko* that Congress actually considered the subject of arbitration when enacting the securities laws. Accordingly, the task of the *Wilko* Court was to determine the precise extent to which the Securities Act required a limitation on the otherwise applicable Federal Arbitration Act. See *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117, 127 (1973). The Court said, "[t]wo policies, not easily reconcilable, are involved in this case" (*Wilko*, 346 U.S. at 438). The Court's reconciliation of those policies turned on its perception, at the time of decision, of the defects of arbitration as a means of enforcing statutory rights.[6]

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[5] This brief does not address the question whether, in particular circumstances, there are procedural rights that cannot be waived.

[6] Justices Frankfurter and Minton, dissenting in *Wilko*, plainly read the opinion as finding a violation of Section 14 only because the

Accordingly, under the plain language of Section 29(a) of the Exchange Act, construed in conformity with *Wilko*'s construction of Section 14 of the Securities Act, an agreement to arbitrate a claim under the Exchange Act or its implementing regulations is enforceable by the defendant unless arbitration is inadequate to protect substantive statutory rights, so that an agreement to arbitrate is tantamount to a waiver of those rights. The *Wilko* Court found arbitration inadequate in 1953 and therefore held the arbitration agreement before it unenforceable. The Court based its holding not on a view of the particular arbitration in that case, which had not yet taken place, but on its view of arbitration and its protections generally. As we next show, that view is no longer warranted in cases like the present, where the arbitration procedures have subsequently come under the oversight of the Commission. Since mechanisms now exist to ensure that arbitration provides an effective means by which investors like respondents can pursue claims against their brokers under the securities laws, an agreement to arbitrate such claims is not a waiver of compliance with the provisions of those laws and is therefore enforceable under the Federal Arbitration Act.

Court believed that arbitration could not effectively enforce the substantive "protective provisions" of the securities laws. The dissent disagreed with the majority only in its assessment of the adequacy of arbitration (346 U.S. at 439-440). The dissent concluded that the arbitration agreement should be enforceable because there was "nothing in the record * * * to indicate that the arbitral system * * * would not afford the plaintiff the rights to which he is entitled" (346 U.S. at 439 (footnote omitted)). The dissent cautioned, however, that, "[i]f arbitration inherently precluded full protection of the rights § 12(2) of the Securities Act affords to a purchaser of securities, or if there were no effective means of ensuring judicial review of the legal basis of the arbitration, then, of course, an agreement to settle the controversy by arbitration would be barred by § 14 * * *" (*ibid.*).

B. Arbitration Subject To The Commission's Post-1975 Regulatory Authority Is Adequate To Enforce Substantive Duties Under The Securities Laws

The view of arbitration on which *Wilko* rested is today inappropriate in cases involving disputes between registered broker-dealers and their customers. Under Section 19 of the Exchange Act, 15 U.S.C. 78s, the Commission has broad regulatory authority over securities exchanges and other self-regulatory organizations (SROs). Since 1975, when Congress amended Section 19 to expand that authority, the Commission has had the power to ensure that arbitration procedures prescribed by the SROs are adequate to enforce the rights of customers against brokerage firms that are members of SROs. In these circumstances, the suspicion of arbitration on which *Wilko* rested is inappropriate, and an agreement to arbitrate accordingly should not be deemed a waiver of rights under the Exchange Act.

1. The result in *Wilko* did not depend on any evidence of actual congressional consideration of the adequacy of arbitration to enforce rights arising under the securities laws. It was determined instead by this Court's mistrust of arbitration. The Court, however, has come to another assessment of arbitration since *Wilko* was decided in 1953. As the Court recently stated, "we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution." *Mitsubishi Motors Corp.*, slip op. 12. See also *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. at 220 & n. 6; *Southland Corp.* v. *Keating*, 465 U.S. 1, 13-17 (1984); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 510-511 & n. 4. Indeed, this Court has emphasized that there is a strong federal policy favoring arbitration as an alternative method of dispute resolution—a method that does not re-

quire sacrifice of substantive rights and is typically faster and cheaper than traditional litigation. *Mitsubishi Motors Corp.*, slip op. 13.

2. There has also been a change in the particular statutory context in which this case arises. In 1975, the Commission's oversight power was enlarged, giving it the power to ensure the adequacy of arbitration procedures employed in a case like the present one. This change enables the Court to decide this case without broader consideration of the principles affecting the arbitrability of statutory claims generally.

The regulatory scheme established by the Exchange Act has long relied in large part on the efforts of the SROs—the national securities exchanges and registered securities associations—subject to Commission oversight. See generally S. Rep. 94-75, 94th Cong., 1st Sess. 22-23 (1975). Any registered broker-dealer effecting transactions in securities must be a member of an SRO. Section 15(b)(8), 15 U.S.C. (Supp. II) 78*o*(b)(8). SROs are required to register with the Commission, to promulgate rules governing the conduct of their members, and to enforce compliance by their members with those rules and with the federal securities laws. See, *e.g.*, Section 6 of the Exchange Act, 15 U.S.C. 78f (regarding securities exchanges); Section 15A of the Exchange Act, 15 U.S.C. 78*o*-3 (regarding securities associations). In order to ensure compliance with these statutory requirements, the Commission has long had authority to oversee and to regulate SRO activities. See generally Section 19 of the Exchange Act, 15 U.S.C. 78s.

The Commission's authority over arbitration procedures is part of its broad Section 19 power over SRO rules. In 1953, however, when this Court decided *Wilko*, the Commission's authority over SRO rules was much more circumscribed than it is today. With respect to

securities associations, which were not at issue in *Wilko,*[7] the Commission's authority, though broad, was weaker than it is now. The Commission's authority over the rules of exchanges was much more limited and appears not to have included any authority over their arbitration rules at all.[8] It was not until the 1975 amendments to the 1933 and 1934 Acts—the " 'most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act of 1934' "[9]—that Congress granted the Commission its present expansive authority

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[7] The arbitration agreement at issue in *Wilko* specified that any arbitration proceedings would be governed by the customer's choice from among certain specified sets of arbitration rules, not including the rules prescribed by any securities association. 346 U.S. at 432 n.15.

[8] The then-existing Section 19(b) gave the Commission authority to "alter or supplement" exchange rules only with respect to specifically enumerated areas (which did not include arbitration procedures) or "similar matters." 48 Stat. 898 (amended 1975). The Commission's authority over the rules of securities associations, while broader, was likewise limited in important respects. Then-existing Section 15A, 52 Stat. 1070 (amended 1975), authorized the Commission to disapprove "any change in or addition to" a securities association's rules (Section 15A(j), 15 U.S.C. (1964 ed.) 78*o*-3(j) (amended 1975)), and to "abrogate any rule" of an association if the Commission found abrogation necessary or appropriate to effectuate the purposes of the Act (Section 15A(k)(1), 15 U.S.C. (1964 ed.) 78*o*-3(k)(1) (amended 1975)). The Commission's authority to "alter or supplement" association rules, however, extended only to certain enumerated matters, none of which included arbitration procedures. Section 15A(k)(2), 15 U.S.C. (1964 ed.) 78*o*-3(k)(2) (amended 1975).

[9] *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 384-385 (1983) (quoting *Securities Acts Amendments of 1975: Hearings on S. 249 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs;* 94th Cong., 1st Sess. 1 (1975)).

over exchange rules.[10] The 1975 amendments were designed to enhance greatly the Commission's authority over SRO rules and procedures. See S. Rep. 94-75, 94th Cong., 1st Sess. 22-23, 29-32 (1975).

Under current law, each SRO must file with the Commission any proposed change to its rules (Section 19(b)(1), 15 U.S.C. 78s(b)(1)), including the rules and procedures governing the conduct of arbitration programs administered by the SRO. Upon the filing of any proposed rule change, the Commission must publish notice of the change and provide interested parties an opportunity to comment (*ibid.*). Subject to certain exceptions, no proposed rule change may take effect unless approved by the Commission (*ibid.*). The Commission must grant such approval if it finds that the proposed rule is consistent with the requirements of the 1934 Act and with the rules and regulations thereunder applicable to SROs. Section 19(b)(2), 15 U.S.C. 78s(b)(2). Moreover, the Commission may, on its own initiative, "abrogate, add to, and delete from" any SRO rule if it finds such changes necessary or appropriate to further the purposes of the Act. Section 19(c), 15 U.S.C. 78s(c). In short, the Commission has sweeping authority over the rules adopted by SROs relating to arbitration of customer disputes, including the power to mandate the adoption of any additional rules it deems necessary to ensure the adequacy of an SRO's arbitration system.

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[10] Pub. L. No. 94-29, § 16, 89 Stat. 146. Pursuant to the 1975 amendments, the Commission now has authority over *all* SRO rules, including those of the exchanges; the Commission's authority is not limited to enumerated categories. See Section 19(b) and (c), 15 U.S.C. 78s(b) and (c). See also S. Rep. 94-75, 94th Cong., 1st Sess. 31 (1975) ("[t]he bill would give the SEC clear authority to amend any self-regulatory organization's rules in any respect consistent with the objectives of the Exchange Act").

The Commission has exercised this new authority since 1975 in several ways specifically designed to promote fair and effective arbitral forums for the resolution of disputes between customers and SRO-member brokerage firms. Chief among them was the Commission's promotion, in 1977, of the formation of the Securities Industry Conference on Arbitration, a group consisting of representatives of various SROs, the Securities Industry Association, and the public, and created to develop a uniform arbitration code.[11] The Conference drafted the Uniform Code of Arbitration, and the Code has since been adopted by all of its SRO members.[12]

Pursuant to Section 19(b), 15 U.S.C. 78s(b), and Rule 19b-4 thereunder, 17 C.F.R. 240.19b-4, the Commission has approved the Code as part of the rules of the various SROs. See, *e.g.*, Securities Exchange Act Release No. 16390 (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979). In so doing, the Commission noted that the Uniform Arbitration Code "marks a substantial improvement over the various arbitration procedures currently being utilized by the securities industry and represents an important step toward establishing a uniform system for resolving investor complaints through arbitration" (*id.* at 1199 (foot-

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[11] See Securities Exchange Act Release No. 13470, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,136 (Apr. 26, 1977); Katsoris, *The Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279, 283-284 (1984).

[12] See, *e.g.*, New York Stock Exchange, Inc. Const., art. XI, 2 N.Y.S.E. Guide (CCH) ¶¶ 1501-1503 (1984); Rules 600-634 of the N.Y.S.E. (*id.* ¶¶ 2600-2634); Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., N.A.S.D. Man. (CCH) ¶¶ 3701-3743 (1986); Arbitration Rules of the American Stock Exchange, Inc., 2 Am. Stock Ex. Guide (CCH) ¶¶ 9540-9551J (1984). See also Appendix A to Securities Industry Association, Inc. Amicus Curiae Brief (reprinting Uniform Code of Arbitration).

note omitted)). The arbitration procedures of the New York Stock Exchange, the American Stock Exchange, and the National Association of Securities Dealers, mentioned in the arbitration agreement at issue in this case, were specifically approved by the Commission (*ibid.*).[13]

3. Although the question presented in this case is similar to that presented in *Wilko*, the circumstances in 1986 compel a different answer. Today there still is no specific expression of congressional intent on the arbitrability of securities-law claims.[14] Rather, the Court

[13] Besides promoting and approving the Uniform Code, the Commission has also taken other actions concerning arbitration designed to protect investors. In 1979 the Commission issued a release announcing that, prior to signing a standard customer agreement containing an arbitration clause, customers should be advised by the broker that, under the existing case law, they are not foreclosed from seeking a judicial remedy. Securities Exchange Act Release No. 15984, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,122 at 81,978 (July 2, 1979). (The courts below did not have occasion to consider any possible bearing of this release on the intentions of the parties to the contract at issue in this case.) In 1983, the Commission promulgated Rule 15c2-2, 17 C.F.R. 240.15c2-2, which codified its view under the existing case law that the insertion of language in broker-customer agreements purporting to bind customers to arbitration of all future disputes is "a misleading statement of customers' rights under the federal securities laws." Securities Exchange Act Release No. 20397, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,452, at 86,357 (Nov. 18, 1983). These actions were premised on the Commission's assumption, based on court of appeals decisions following *Wilko*, see note 3, *supra*, that agreements to arbitrate Rule 10b-5 claims were not, in fact, enforceable.

In 1975, the Commission filed an amicus brief in *Ayres* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir.), cert. denied, 429 U.S. 1010 (1976), urging extension of *Wilko* to a Section 10(b) claim. As the present brief indicates, the Commission has reconsidered its position and no longer holds the view urged in the 1975 brief.

[14] Contrary to the suggestion of several courts of appeals (*Wolfe* v. *E.F. Hutton & Co.*, 800 F.2d at 1032; *Conover* v. *Dean Witter Reynolds, Inc.*, 794 F.2d at 524; *Weissbuch* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d at 836; *Ayres* v. *Merrill Lynch, Pierce,*

must once again determine whether arbitration adequately protects statutory rights. Today, agreements to arbitrate in accordance with SRO rules adopted pursuant to the Exchange Act and approved by the Commission should not be viewed as waiving the protections of the Exchange Act.

The courts, as well as the Commission, can take steps to ensure that the rights afforded by the federal securities laws are enforced in arbitration proceedings. This Court noted in *Mitsubishi Motors Corp.*, slip op. 12, that fraud and overreaching remain grounds for revoking an arbitration agreement. The *Mitsubishi* Court further observed that arbitrators are bound to apply the law and expressly reserved consideration of "the effect of an arbitral tribunal's failure to take cognizance of the statutory cause of action on the claimant's capacity to reinitiate suit

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Fenner & Smith, Inc., 538 F.2d at 537), the only evidence in the 1975 amendments or their legislative history of congressional intent regarding arbitrability of securities-law claims shows that Congress left the issue to the courts.

The Conference Report states that, in amending Section 28 of the Exchange Act, 15 U.S.C. 78bb, to permit compulsory arbitration between brokers and exchanges, Congress "did not change existing law, as articulated in *Wilko* v. *Swan* * * *, concerning the effect of arbitration proceeding provisions in agreements [between brokers and customers]." H.R. Rep. 94-229, 94th Cong., 1st Sess. 111 (1975). And an amendment to Section 15B(b)(2)(D) of the Exchange Act, 15 U.S.C. 78*o*-4(b)(2)(D), permits arbitration among municipal securities dealers but provides that a customer cannot be compelled to arbitrate disputes "except at his instance and in accordance with section 78cc of this title." The statement in the Conference Report merely disclaims any intent to alter *Wilko*. The Section 15B amendment merely forbids arbitration without any agreement by the customer or otherwise than in accordance with Section 29. Neither the amendment nor the Conference Report indicates an intent to preclude further consideration of the *Wilko* issue by the courts. See *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d at 1398 n. 17. Of course, this Court in *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 513-514, had, only one year prior to the 1975 amendments, cast doubt on the applicability of *Wilko* to Exchange Act claims.

in federal court" (slip op. 22 n.19). The point made by Justice Frankfurter in dissent in *Wilko* (346 U.S. at 440, quoting *Wilko* v. *Swan*, 201 F.2d 439, 445 (2d Cir. 1953)) is of course applicable to securities-law plaintiffs:

> Arbitrators may not disregard the law. Specifically they are * * * "bound to decide in accordance with the provisions of section 12(2)." On this we are all agreed. * * * [F]ailure to observe this law "would * * * constitute grounds for vacating the award * * *."

Accordingly, in light of the Commission's oversight authority under Section 19 of the Exchange Act, the customer-broker arbitration agreement in this case does not effect a waiver of the protections of the Act and should therefore be enforced. The same conclusion would apply to agreements to arbitrate any federal securities-law claim where the arbitration procedures are subject to the Commission's Section 19 authority. Thus, a present-day customer-broker agreement to arbitrate pursuant to SRO arbitration procedures would be enforceable, even with respect to claims arising under Section 12(2) of the 1933 Act, the section under which the claim in *Wilko* arose, as long as SRO arbitration procedures are specified.

Not all arbitration agreements covering claims arising under provisions of the securities laws would necessarily involve arbitration procedures subject to the Commission's Section 19 oversight authority. Agreements, for example, between investment advisors and their clients, and certain agreements that might purport to require arbitration of claims arising under the proxy rules, or in tender-offer or public offering contexts, might not specify SRO abitration procedures. No such agreement is before the Court. The argument made in this brief would not apply to such an agreement, and a separate analysis would be necessary to determine whether the arbitration procedures

are adequate to protect statutory rights. We urge the Court to limit its decision in this case to agreements specifying procedures subject to the Commission's oversight authority.

C. The Distinction Between Express and Implied Rights Of Action, And Technical Distinctions Between The 1933 and 1934 Acts, Are Irrelevant To The Decision In This Case

A major purpose of this brief is to urge the Court not to let the unsatisfactorily explained decision in *Wilko* lead it to distinguish that case today on grounds that would in our judgment be productive of mischief. In *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. at 224-225, Justice White, wrestling with *Wilko* in a concurring opinion, suggested that the holding of *Wilko* might be inapplicable to Section 10(b) claims for reasons different from those urged by the Commission above. The Court in *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 513-514, had noted similar potential grounds for not extending *Wilko* to Section 10(b) claims. Although neither Justice White's *Byrd* concurrence nor the Court's opinion in *Scherk* goes beyond pointing out potential grounds of distinction and indicating the impossibility of automatically and "mechanically transplant[ing]" the *Wilko* decision to the 1934 Act (470 U.S. at 224), the Commission believes that it is important for the Court to avoid deciding this case on the basis of any supposed distinction between the two Acts or between express and implied causes of action. In particular, in the Commission's view, reliance on any distinction between express and implied causes of action has no place in the analysis, would be inconsistent with prior decisions of this Court, and might impair the protections of the securities laws.

Justice White noted in his *Byrd* concurrence that *Wilko* relied on three "interconnected statutory provisions" of the 1933 Act: the antiwaiver provision of Section 14; Sec-

tion 12(2), which creates a "special right" different from a common-law action for misrepresentation; and Section 22, which allows suit in any state or federal court of competent jurisdiction. 470 U.S. at 224. He stated that, while Section 29 of the 1934 Act is analogous to Section 14 of the 1933 Act, "counterparts of the other two provisions are imperfect or absent altogether" (470 U.S. at 224).[15] In particular, he noted that the Section 10(b) cause of action is implied rather than express. The phrase " 'waive compliance with any *provision of this chapter*' " in Section 29 is, he said, "literally inapplicable." *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. at 225 (White, J., concurring) (citation omitted; emphasis added). He added, "*Wilko*'s solicitude for the federal cause of action—the 'special right' established by Congress * * *—is not necessarily appropriate where the cause of action is judicially implied and not so different from the common-law action" (*ibid.*; see *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 513-514).[16]

These potential distinctions should play no role in the analysis of this case. To begin with, the difference in the jurisdictional provisions is of no significance either to the interpretation of the two statutory antiwaiver provisions or in relation to the policy of preserving the protections of the Acts.[17] Nor is there significance to any differences in

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[15] In fact, the jurisdictional section of the 1933 Act, Section 22, 15 U.S.C. 77v, has a counterpart in Section 27 of the 1934 Act, 15 U.S.C. 78aa. The latter allows suit only in federal court.

[16] Subsequent to *Byrd*, a number of district courts, including the district court in this case, and the Eighth Circuit in *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, have adopted some of these distinctions in concluding that *Wilko* should not be extended to Section 10(b) claims. See Pet. App. A32-A38, citing cases.

[17] The distinction between the jurisdictional provisions of the 1933 and 1934 Acts is irrelevant to the issue in this case. The issue is whether a "judicial forum" (*Wilko*, 346 U.S. at 435) must be available for the vindication of rights under the 1933 Act—not whether a

the procedural protections surrounding Section 10(b) of the 1934 Act and Section 12(2) of the 1933 Act[18] or to differences in how closely they compare to common-law causes of action.[19] There is simply no reason to believe,

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claimant has a choice of state or federal courts. Some authorities have attributed the difference between Section 22 and Section 27 to "pure happenstance." Note, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 Duke L.J. 548, 567 (citing ALI, *Study of the Division of Jurisdiction Between State and Federal Courts* 183 (1969)). See also Note, *The Securities Exchange Act and the Rule of Exclusive Federal Jurisdiction*, 89 Yale L.J. 95, 109 n.58 (1979).

[18] In some respects private plaintiffs in Section 10(b) actions are afforded greater procedural protections than are plaintiffs who assert the express remedy provided by Section 12(2). For example, under the Securities Act there is a statute of limitations of one year from the time the violation was or should have been discovered, with an absolute limit of three years from the offer or sale of the security (Section 13, 15 U.S.C. 77m), whereas in a Section 10(b) action the law of the forum state provides the applicable statute of limitations, which is usually longer. See *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 210 n.29 (1976). In addition, Section 11(e) of the Securities Act, 15 U.S.C. 77k(e), authorizes a court to require a Section 12(2) plaintiff to post a bond for costs, including attorneys' fees, and in certain circumstances assess costs against the plaintiff; no comparable provisions apply to plaintiffs in Section 10(b) actions. 425 U.S. at 209-210. Finally, the Exchange Act provides a wider choice of venue within the federal court system than does the Securities Act. Compare Section 27 of the Exchange Act, 15 U.S.C. 78aa, with Section 22(a) of the Securities Act, 15 U.S.C. 77v(a).

[19] In *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 388-389 (1983), this Court recognized a significant difference between common-law fraud actions and Section 10(b) actions—the plaintiff's burden of proof. A plaintiff under Section 10(b) must prove a violation by the "preponderance of the evidence," notwithstanding the traditional use of a "clear and convincing evidence" standard in common-law fraud actions. As the Court stated (459 U.S. at 388-389 (footnote omitted)):

> [T]he antifraud provisions of the securities laws are not coextensive with common-law doctrines of fraud. Indeed, an important

based on the statutory language or policies, that any of these differences reflects any congressional intent that a Section 12(2) claim, but not a Section 10(b) claim, shall be nonarbitrable.

Most critical, Section 10(b) is just as much a "provision" of the 1934 Act, with which persons trading in securities are required to "comply," as Section 12(2) is of the 1933 Act. The question presented by the language of the anti-waiver provisions, Sections 14 and 29, and first analyzed in *Wilko*, is whether acceptance of arbitration is, because of the supposed inadequacy of that remedy, tantamount to a waiver of "compliance" with any substantive "provision" of the Act in question. The answer to that question does not depend in any way on whether the *plaintiff*'s right to sue under a particular provision is expressly stated or implied. The adequacy of arbitration to ensure the *defendant*'s "compliance" with the provisions of the Act is wholly independent of whether Congress made a right of action express or the courts inferred it. That distinction simply has no place in a proper analysis of the issue here.

Reliance on the distinction, moreover, would be inconsistent with this Court's explanations of the nature of the implied right or action under Section 10(b). In *Herman & MacLean* v. *Huddleston*, 459 U.S. at 380 (footnote omitted), the Court stated that a private right of action under Section 10(b) and Rule 10b-5 "has been consistently recognized for more than 35 years. The existence of this implied remedy is simply beyond peradventure." That Congress decided to leave Section 10(b) intact when it extensively revised the Exchange Act in 1975 reconfirms the existence of the private right of action. 459 U.S. at

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purpose of the federal securities statutes was to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry.

384-386; cf. *Merrili Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 381-382 (1982) ("that a comprehensive reexamination and significant amendment of the [Commodity Exchange Act] left intact the statutory provisions under which the federal courts had implied a cause of action is itself evidence that Congress affirmatively intended to preserve that remedy") (footnote omitted); *Lorillard* v. *Pons*, 434 U.S. 575, 580 (1978) ("Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it reenacts a statute without change * * *"). More generally, "[t]o say that a private cause of action is implied is to say that Congress intended such an action to exist." *Wolfe* v. *E.F. Hutton & Co.*, 800 F.2d at 1039 (Tjoflat, J., concurring). See *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 575 (1979) ("[t]he central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action"). Thus, with regard to congressional intent in general, and the intent to preserve investor protections in particular, express and implied rights of action stand on an equal footing.

Further, this Court has specifically recognized in two recent decisions that the Section 10(b) implied right of action is of no less stature, and is no less entitled to full respect and enforcement, than express rights provided by the securities laws. In *Huddleston,* the Court rejected the argument that an overlap should not exist between express and implied rights and held that the express remedy provided by Section 11 of the 1933 Act, 15 U.S.C. 77k, does not displace the implied remedy under Section 10(b) and Rule 10b-5. In *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, No. 84-679 (June 21, 1985), the Court rejected the argument that the in pari delicto defense be given a broader application in private Section 10(b) actions because that cause of action is implied rather than express. The Court said, "implied private actions provide 'a most

effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action.' " *Bateman Eichler*, slip op. 10 (quoting *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964)). See also *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975). After *Huddleston* and *Berner*, any suggestion of greater congressional solicitude for express rights of action than for the implied right of action under Rule 10b-5 would be insupportable.

Given the historic recognition of the importance of implied causes of action, the Commission urges the Court not to premise its decision in this case on a distinction between express and implied remedies. That distinction is irrelevant to the proper analysis of the case and is incompatible with the importance of the Section 10(b) remedy in the arsenal of securities law protections. There is, in addition, an important practical consideration. Any reliance on such a distinction might be interpreted as suggesting that the Section 10(b) implied right of action is somehow inferior to express rights. The Commission urges the Court to avoid any suggestion that might thus interfere with the effective enforcement of the securities laws.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF THE AMERICAN ARBITRATION ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

PAGE

TABLE OF AUTHORITIES iii

INTEREST OF *AMICUS CURIAE* 1

SUMMARY OF ARGUMENT 3

ARGUMENT 4

A. THE FEDERAL ARBITRATION ACT REQUIRES ENFORCEMENT OF ARBITRATION CLAUSES FOR COMMERCIAL DISPUTES BETWEEN CONTRACTING PARTIES—INCLUDING DISPUTES BASED UPON STATUTORY CLAIMS—UNLESS CONGRESS SPECIFICALLY INTENDED TO PRECLUDE ARBITRATION 4

B. *WILKO V. SWAN* SHOULD BE RE-EXAMINED SINCE IT WAS BASED ON A NOW CLEARLY OUTDATED AND IMPROPER SUSPICION OF ARBITRATION RATHER THAN ON EVIDENCE OF CONGRESSIONAL INTENT TO PRECLUDE ENFORCEMENT OF ARBITRATION CLAUSES COVERING SECURITIES ACT DISPUTES 7

1. There Is No Evidence That Congress Intended To Preclude Arbitration Of Securities Act Disputes 7

a. The Non-Waiver Provision Of The Securities Act Does Not Evidence A Congressional Intent To Preclude Arbitration 7

b. Nothing In The Legislative History Of The Securities Act Evidences A Congressional Intent To Preclude Arbitration ... 10

PAGE

2. *Wilko* Was Based On An Assumption That Congress Intended To Preclude Arbitration Because Of A Suspicion Of Arbitration That Was Specifically Rejected By Congress In The Arbitration Act 11

3. This Court's Recent Decisions—And The Extensive Experience With Arbitration Since *Wilko*—Show That Arbitration Is A Fair And Effective Method For Resolving Securities Disputes. Consequently, *Wilko* Should Be Overruled 12

C. THE SECOND CIRCUIT'S BROAD "PUBLIC POLICY" EXCEPTION TO THE ENFORCEMENT OF ARBITRATION CLAUSES CONFLICTS WITH THE ARBITRATION ACT AND THE RECENT DECISIONS OF THIS COURT .. 19

CONCLUSION 21

APPENDICES

Appendix A: Statutory Provisions Involved 1a

Appendix B: American Arbitration Association Commercial Arbitration Rules 6a

TABLE OF AUTHORITIES

Cases	PAGE
Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974)..	15
American Safety Equipment Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968).....	19, 20
Barrentine v. Arkansas-Best Freight System, Inc., 450 U.S. 728 (1981).....	15
Boyd v. Grand Trunk Western R. Co., 338 U.S. 263 (1949).....	9
Commissioner v. Estate of Church, 335 U.S. 632 (1949)	18
Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. 145 (1968).....	13
Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213 (1985).....	4, 5, 6, 7, 12
Girouard v. United States, 328 U.S. 61 (1946).....	19
Globus v. Law Research Service, Inc., 287 F. Supp. 188 (S.D.N.Y. 1968), *aff'd in part and rev'd in part*, 418 F.2d 1276 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970).....	16
Haynes v. United States, 390 U.S. 85 (1968).....	11
Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 797 F.2d 1197 (3d Cir. 1986).....	19, 20
May v. Heiner, 281 U.S. 238 (1930).....	19
Mayaja, Inc. v. Shearson Lehman Brothers, Inc., No. 85-2762, slip op. (5th Cir. Oct. 24, 1986).....	20
McMahon v. Shearson/American Express, Inc., 788 F.2d 94 (2d Cir. 1986).....	6, 19
Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 105 S. Ct. 3346 (1985).....	*passim*

PAGE

Monell v. Department of Social Services, 436 U.S. 658 (1978) 18

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Morton v. Mancari, 417 U.S. 535 (1974) 10

Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983) 5, 12

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Posadas v. National City Bank, 296 U.S. 497 (1936) ... 9, 10

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967) 2, 12

Radzanower v. Touche Ross & Co., 426 U.S. 148 (1976) 9

St. Martin Evangelical Lutheran Church v. South Dakota, 451 U.S. 772 (1981) 9, 10

Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974) 2, 5, 12, 17

Southland Corp. v. Keating, 465 U.S. 1 (1984) 4, 5, 6, 12

Toledo Newspaper Co. v. United States, 247 U.S. 402 (1918) 18

United States v. Borden Co., 308 U.S. 188 (1939) 9, 10

United States v. Price, 361 U.S. 304 (1960) 11

United States v. Schwimmer, 279 U.S. 644 (1929) 19

Watt v. Alaska, 451 U.S. 259 (1981) 9, 10

Weiss v. Tenney Corp., 47 F.R.D. 283 (S.D.N.Y. 1969) 16

Wilko v. Swan, 346 U.S. 427 (1953) .....*passim*

PAGE

Statutes

Administrative Procedure Act, 5 U.S.C. § 706(2) 8

Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* .....*passim*

9 U.S.C. § 2 .....4, 6, 9

9 U.S.C. § 7 13

9 U.S.C. § 9 15

9 U.S.C. § 10(d) 15

Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1962 *et seq* 3, 19, 21

Securities Act of 1933, 15 U.S.C. § 77a *et seq* .....*passim*

15 U.S.C. § 77n 8

Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* 2, 3, 8, 19, 21

15 U.S.C. § 78s(c)..... 13

Legislative Materials

H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924) 4, 5, 6

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Rules

17 C.F.R. § 240.15c2-2..... 8

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PAGE

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PAGE

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

No. 86-44

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF THE AMERICAN ARBITRATION ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

Interest of *Amicus Curiae*

The American Arbitration Association ("AAA") files this brief as *amicus curiae* in support of petitioners by written consent of all parties, pursuant to Rule 36.2 of the Rules of this Court.

The AAA is an educational, membership organization incorporated in 1926 and operating under the Not-for-Profit Corporation Law of the State of New York. The AAA is dedicated to the dissemination of knowledge throughout the United States and other countries regarding arbitration and other methods of alternative dispute resolution. The AAA does not act as an arbitrator of disputes; rather, it provides impartial rules, procedures, panels of experienced arbitrators and administrative assistance to parties desiring to use its neutral facilities. The AAA's role as an impartial administrator of arbitration has been recognized in numerous state and federal statutes and regulations. *See infra* at 18 n.26. In 1985, approximately 45,000 arbitrations were conducted under the auspices of the AAA.

The AAA also conducts extensive educational programs on arbitration and other aspects of alternative dispute resolution, and administers a variety of arbitration systems in different industries, including the construction, textile, insurance, real estate, computer and grain industries.

This is the first case in which this Court has been asked to determine the arbitrability of a claim under the Securities Exchange Act of 1934 (the "Exchange Act") in a domestic commercial dispute. The AAA believes that it can present to this Court a different perspective from the one presented by the parties. By virtue of its sixty years of experience in private dispute resolution, the AAA is uniquely qualified to address issues before the Court as they relate to arbitration agreements. The AAA has only one concern here: to have this Court reaffirm its fundamental support for arbitration and for the rights of parties in commercial relationships to elect arbitration as the certain means by which future disputes may be resolved.

The AAA has appeared previously in this Court as *amicus curiae* in cases involving the arbitrability of various disputes, including *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974); and *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967).

Summary of Argument

The Federal Arbitration Act, which established a strong national policy in favor of arbitration, requires enforcement of agreements to arbitrate commercial disputes. As this Court has held, this includes enforcing arbitration clauses covering statutory claims—such as those asserted under the Exchange Act and RICO here—unless Congress has expressly precluded arbitration of such claims. (Point A)

Because there is nothing in the Securities Act of 1933 (the "Securities Act")—or in its legislative history—evidencing Congress's intent to preclude arbitration, arbitration agreements should be enforced as to commercial disputes under that statute. *Wilko v. Swan*, 346 U.S. 427 (1953), which held that arbitration clauses were unenforceable as to disputes under the Securities Act, should be overruled since it was not based on evidence of Congressional intent to preclude arbitration. Rather, *Wilko* was based on a suspicion of arbitration which is in conflict with the underlying purpose of the Arbitration Act and is contrary to the recent decisions of this Court. Moreover, *Wilko*'s fundamental assumptions have been disproven by the extensive experience with arbitration in the more than thirty years since it was decided. That experience demonstrates that arbitration is a fair and effective method for resolving commercial disputes in general and securities disputes in particular. That it is not biased against customers is shown by the fact that customers have won over two-thirds of the recent cases against securities firms arbitrated to decision under the auspices of the AAA. The positive experience with commercial arbitration—which has resulted in its virtually uniform acceptance by courts in the United States and elsewhere—negates the suspicion of arbitration underlying *Wilko*. Consequently, arbitration clauses should be enforced as to Securities Act claims; *a fortiori* they should be enforced as to implied causes of action under the Exchange Act. (Point B)

Similarly, there is no evidence of Congressional intent to preclude arbitration of RICO claims. Courts which have held

such claims to be non-arbitrable have relied on a broad so-called "public policy" exception to arbitration that is directly contrary to the Arbitration Act and the decisions of this Court. (Point C)

ARGUMENT

A. THE FEDERAL ARBITRATION ACT REQUIRES ENFORCEMENT OF ARBITRATION CLAUSES FOR COMMERCIAL DISPUTES BETWEEN CONTRACTING PARTIES—INCLUDING DISPUTES BASED UPON STATUTORY CLAIMS—UNLESS CONGRESS SPECIFICALLY INTENDED TO PRECLUDE ARBITRATION

The Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, makes a written agreement to arbitrate "in any . . . contract evidencing a transaction involving commerce . . . valid, irrevocable and enforceable. . . ." 9 U.S.C. § 2. The "preeminent concern" of Congress in passing the Arbitration Act was "to enforce private agreements [to arbitrate] into which parties had entered." *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985). As this Court has noted, the Arbitration Act "was designed to overcome an anachronistic judicial hostility to agreements to arbitrate," *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346, 3354 n.14 (1985), and to replace it with a "national policy favoring arbitration." *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984).[1] As a result

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1 The House Report accompanying the Arbitration Act stated that

> The purpose of this bill is to make valid and enforceable agreements for arbitration contained in contracts involving interstate commerce or within the jurisdiction of admiralty, or which may be the subject of litigation in the Federal Courts.

H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924). The House Report explained that the need for the law

> arises from . . . the jealousy of the English Courts for their own jurisdiction. . . . This jealousy survived for so lon[g] a period that

(*Footnote continued on next page*)

of the "liberal federal policy favoring arbitration agreements," *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983), "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration," *id.* at 25, and agreements to arbitrate commercial disputes must be "rigorously enforce[d]." *Dean Witter*, *supra*, 470 U.S. at 221.

The "national policy favoring arbitration" which Congress declared in the Arbitration Act applies with equal force where "a party bound by an arbitration agreement raises claims founded on statutory rights." *Mitsubishi*, *supra*, 105 S. Ct. at 3354. Thus, an arbitration clause covering statutory claims must be enforced in the absence of "Congressional intention expressed in some other statute . . . [that] agreements to arbitrate [should] be held unenforceable." *Id.* at 3355.

> We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history. . . . Having made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue.

Id. at 3355.

(*Footnote continued from previous page*)

> the principle became firmly embedded in the English common law and was adopted with it by the American courts. . . .

Id. at 1-2. *See also Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510 (1974) (Arbitration Act, "reversing centuries of judicial hostility to arbitration agreements, was designed . . . to place arbitration agreements 'upon the same footing as other contracts' ") (citation and footnote omitted); *Dean Witter*, *supra*, 470 U.S. at 219 ("The legislative history of the [Arbitration] Act establishes that the purpose behind its passage was to ensure judicial enforcement of privately made agreements to arbitrate."); *Southland Corp.*, *supra*, 465 U.S. at 12-13; *Mitsubishi*, *supra*, 105 S. Ct. at 3353-54.

The Arbitration Act represents a clear statement of Congressional support for party autonomy in contractual matters. "[P]assage of the [Arbitration] Act was motivated, first and foremost, by a congressional desire to enforce [arbitration] agreements into which parties had entered." *Dean Witter*, *supra*, 470 U.S. at 220 (footnote omitted).[2] Simply stated, Congress has "mandated the enforcement," *Southland Corp.*, *supra*, 465 U.S. at 10, of agreements[3] to arbitrate commercial[4] disputes between contracting parties—including disputes raising statutory claims—unless Congress expressly intended to preclude arbitration of such disputes.

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2 As the House Report stated:

> Arbitration agreements are purely matters of contract and the effect of the bill was simply to make the contracting party live up to his agreement. He can no longer refuse to perform a contract when it becomes disadvantageous to him. An arbitration agreement is placed upon the same footing as other contracts, where it belongs.

Id. at 1. *See also* S. Rep. No. 536, 68th Cong., 1st Sess. 1, 3 (1924) (citing "practical justice in the enforced arbitration of disputes where written agreements for that purpose have been voluntarily and solemnly entered into").

3 Where an agreement to arbitrate is not voluntary, the Arbitration Act does not contemplate its enforcement. 9 U.S.C. § 2; *see Mitsubishi*, *supra*, 105 S. Ct. at 3354. In this regard, a contract to arbitrate is like any contract, *i.e.*, it will not be enforced if entered into non-voluntarily, for example, under duress or by mistake. Here, the district court expressly rejected respondents' claim that the arbitration clause was not voluntarily agreed to, a finding which was not disturbed by the Second Circuit. *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94, 96, 99 n.6 (2d Cir. 1986). As was the case in *Mitsubishi*, "there is no basis for assuming" that the arbitration clause was not voluntarily agreed to. 105 S. Ct. at 3357. If it was not, respondents had the opportunity to make such a showing and avoid the clause. *Id.*

4 The Arbitration Act applies to "transaction[s] involving commerce." 9 U.S.C. § 2.

B. *WILKO V. SWAN* SHOULD BE RE-EXAMINED SINCE IT WAS BASED ON A NOW CLEARLY OUTDATED AND IMPROPER SUSPICION OF ARBITRATION RATHER THAN ON EVIDENCE OF CONGRESSIONAL INTENT TO PRECLUDE ENFORCEMENT OF ARBITRATION CLAUSES FOR SECURITIES ACT DISPUTES[5]

1. There Is No Evidence That Congress Intended To Preclude Arbitration Of Securities Act Disputes

a. The Non-Waiver Provision Of The Securities Act Does Not Evidence A Congressional Intent To Preclude Arbitration

In *Wilko v. Swan*, 346 U.S. 427 (1953), a divided Court, acknowledging that it was faced with a difficult issue, held that an arbitration clause in an agreement between a securities broker and his customer was not enforceable as to a claim

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5 We recognize that the question of the arbitrability of Securities Act disputes is not directly before the Court in this case. However, there are at least three reasons why the Court should nevertheless overrule *Wilko* now. First, a holding that Exchange Act claims are arbitrable which does not address the continuing validity of *Wilko* could well result in continuing confusion among the lower courts as to the arbitrability of Securities Act claims and other statutory claims. Second, since under *Dean Witter* arbitrable claims must be arbitrated even if intertwined with non-arbitrable claims, a decision that Exchange Act claims are arbitrable which does not address the continuing validity of *Wilko* will likely lead to fragmented and duplicative proceedings until this Court addresses *Wilko*. Third, given the significant burden of securities litigation on the federal courts (over 3,000 securities and commodities exchange civil actions were filed in federal district courts in the twelve month period ending March 31, 1986; *see* Statistical Analysis and Reports Division, Administrative Office of the U.S. Courts, *Federal Judicial Workload Statistics*, Table C-2 at 13 (1986)), a burden which will only increase with the dramatic increase in public participation in the securities markets, *see* New York Stock Exchange, *Shareownership 1985* at 3 (number of shareholders has increased from approximately 7 million in 1953 when *Wilko* was decided to over 47 million in 1985), failure to overrule *Wilko* now will permit a continuing flood of securities cases that could better be dealt with through voluntary agreements to arbitrate.

under Section 12 of the Securities Act. In reaching this conclusion, the *Wilko* majority relied upon the non-waiver clause of the Securities Act, which provides:

> Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the [Securities Exchange] Commission shall be void.

15 U.S.C. § 77n. This clause prevents those regulated by the statute (including issuers, underwriters, dealers and brokers) from attempting to relieve themselves from compliance with any of the substantive standards of conduct imposed by the statute, such as the filing and disclosure requirements imposed on an issuer of securities. However, neither any "provision" of the Securities Act, nor any rule or regulation of the Securities Exchange Commission (the "SEC"),[6] requires that disputes arising under the Act be litigated only in a judicial forum. Moreover, such substantive standards of conduct do not, by implication, incorporate the judicial system as the sole method of dispute resolution. Consequently, a clause providing for arbitration of disputes cannot properly be construed as a stipulation waiving compliance with any of the provisions of the Securities Act. As this Court held in *Mitsubishi*:

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6 Although the SEC promulgated a regulation purporting to prohibit agreements binding customers to arbitrate future claims arising under the securities laws, 17 C.F.R. § 240.15c2-2, "in adopting [that] Regulation . . . the SEC intended only to reflect what it believed to be a settled principle of law (*i.e.* that predispute arbitration agreements are unenforceable under both the [Securities] Act and the [Exchange] Act). As this opinion indicates, the SEC was mistaken." *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, 1398 n.17 (8th Cir. 1986).

Regulation 15c2-2 appears to have been ignored by the SEC as well as by most courts, as *amicus* is aware of no instance of the SEC's attempting to enforce it. In any event, since Regulation 15c2-2 conflicts with the Arbitration Act, it was beyond the SEC's jurisdiction to promulgate it. 5 U.S.C. § 706(2)(A), (C).

> By agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.

105 S. Ct. at 3355; *see also Wilko*, *supra*, 346 U.S. at 439-40 (Frankfurter, J., dissenting). Congress had passed the Arbitration Act in 1925, only eight years before the Securities Act. It could easily have added a provision to the Securities Act expressly exempting it from the Arbitration Act. That it did not do so is evidence that it did not intend the Securities Act to create an exception to the statutory rule created by the Arbitration Act.

Indeed, what the *Wilko* majority did was find a partial repeal of the Arbitration Act by implication, based upon the non-waiver provision of the Securities Act. However, "[t]he cardinal rule is that repeals by implication are not favored." *Posadas v. National City Bank*, 296 U.S. 497, 503 (1936). Rather, it is presumed that when Congress wants to repeal or limit an earlier statute, it will do so explicitly. *See, e.g., St. Martin Evangelical Lutheran Church v. South Dakota*, 451 U.S. 772, 787-88 (1981); *Watt v. Alaska*, 451 U.S. 259, 266-67 (1981); *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 154 (1976); *United States v. Borden Co.*, 308 U.S. 188, 198 (1939); *Posadas*, *supra*.[7] As this Court has explained, whenever possible, two statutes should be interpreted so as to give effect to both:

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7 In this regard the *Wilko* majority's reliance on *Boyd v. Grand Trunk Western R. Co.*, 338 U.S. 263 (1949), was misplaced. *Boyd* held that a choice of venue provision was void as violative of a non-waiver provision in the Federal Employers' Liability Act ("FELA"). *Id.* at 264-65. However, in *Boyd* there was no competing statute involved; rather, the Court was simply interpreting a provision of FELA. Here, in contrast, the non-waiver provision of the Securities Act cannot be construed in isolation because there is a competing statement of Congressional intent embodied in the Arbitration Act, namely that arbitration clauses "in any . . . contract evidencing a transaction involving commerce" are to be enforced. 9 U.S.C. § 2.

> The courts are not at liberty to pick and choose among congressional enactments, and when two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective. "When there are two acts upon the same subject, the rule is to give effect to both if possible. . . . The intention of the legislature to repeal 'must be clear and manifest.' "

Morton v. Mancari, 417 U.S. 535, 551 (1974) (quoting *United States v. Borden Co.*, *supra*, 308 U.S. at 198); *see also Watt v. Alaska*, *supra*; *Posadas*, *supra*. "In the absence of some affirmative showing of an intention by Congress to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable." *Morton*, *supra*, 417 U.S. at 550. The Securities Act does not expressly preclude enforcement of arbitration clauses. It does not reflect a "clear and manifest" intention to repeal the Arbitration Act, and is not "irreconcilable" with it. *Morton*, *supra*, 417 U.S. at 550-51. Consequently, this "long-established canon of [statutory] construction," *St. Martin Evangelical Lutheran Church*, *supra*, 451 U.S. at 788, requires giving effect to the Arbitration Act's terms and holding arbitration clauses enforceable as to Securities Act claims.[8]

b. Nothing In The Legislative History Of The Securities Act Evidences A Congressional Intent To Preclude Arbitration

There is nothing in the legislative history of the Securities Act that evidences Congress's intent to preclude arbitration. It is significant that neither the *Wilko* majority, nor the SEC in

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8 The *Wilko* majority stated that it was faced with two conflicting statements of Congressional policy in the Arbitration Act and the Securities Act, 346 U.S. at 438, but, contrary to the teaching of cases such as *Morton* and *Posadas*, it made no effort to reconcile them. Instead, the majority impermissibly "picked and chose" the enactment it preferred, even though the two statutes are perfectly "capable of co-existence." *Morton*, *supra*, 417 U.S. at 551.

its *amicus* brief in *Wilko*, pointed to *anything* in the legislative history of the Securities Act indicating that Congress intended to exempt it from the express provisions of the Arbitration Act which it had recently passed.[9] Rather, as discussed below, the *Wilko* majority *assumed* a Congressional intent to preclude arbitration based on its suspicion of arbitration as a means of resolving securities disputes. As demonstrated above, the Arbitration Act was intended to overcome just such judicial hostility to arbitration.

2. *Wilko* Was Based On An Assumption That Congress Intended To Preclude Arbitration Because Of A Suspicion Of Arbitration That Was Specifically Rejected By Congress In The Arbitration Act

In holding that the non-waiver provision of the Securities Act precluded arbitration, the *Wilko* majority did not rely on express language to that effect in the Securities Act or its legislative history. Rather, it relied on its suspicion of arbitration as a means for resolving Securities Act disputes. Thus, the *Wilko* majority adopted the argument of the petitioner there that "arbitration lacks the certainty of a suit at law." 346 U.S. at 432, 435. The *Wilko* majority further asserted that the effectiveness of "the provisions of the Securities Act, advantageous to the buyer . . . is lessened in arbitration as compared to judicial proceedings," *id.* at 435, and that arbitrators are not as capable as courts in making "subjective findings on . . . purpose and knowledge." *Id.* at 435-36. Finally, and most significantly, the Court assumed that because, in its view, "the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness,

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9 The statement contained in a 1975 House Conference Committee report apparently recognizing the *Wilko* doctrine, *see* H.R. Rep. No. 229, 94th Cong., 1st Sess. 111, *reprinted in* 1975 U.S. Code Cong. & Admin. News 321, 342 (1975), is not persuasive evidence of the intent of Congress in 1933 when the Securities Act was passed. *See, e.g., Haynes v. United States*, 390 U.S. 85, 87 n.4 (1968); *United States v. Price*, 361 U.S. 304, 313 (1960).

it seems to us that Congress must have intended [the non-waiver provision] to apply to waiver of judicial trial and review." *Id.* at 437.

Conspicuously absent from the Court's discussion was any evidence supporting its assumptions or demonstrating that they were shared by Congress.[10] To the contrary, the majority's assumptions reflect precisely the kind of judicial hostility to arbitration that was expressly rejected by Congress in passing the Arbitration Act.

3. This Court's Recent Decisions—And The Extensive Experience With Arbitration Since *Wilko*—Show That Arbitration Is A Fair And Effective Method For Resolving Securities Disputes. Consequently, *Wilko* Should Be Overruled

In the thirty years since *Wilko* was decided, this Court has overcome the judicial hostility to arbitration reflected in *Wilko* and, in a series of recent decisions, has reflected the intent of Congress as expressed in the Arbitration Act.[11] As this Court stated in *Mitsubishi*,

> we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.

105 S. Ct. at 3354.

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10 As Justice Frankfurter stated in dissent:

> There is nothing in the record before us, nor in the facts of which we can take judicial notice, to indicate that the arbitral system as practiced in the City of New York, and as enforceable under the supervisory authority of the District Court . . . , would not afford the plaintiff the right to which he is entitled.

346 U.S. at 439.

11 *See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, *supra*; *Dean Witter Reynolds Inc. v. Byrd*, *supra*; *Southland Corp. v. Keating*, *supra*; *Moses H. Cone Memorial Hospital v. Mercury*, *supra*; *Scherk v. Alberto-Culver Co.*, *supra*; *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, *supra*.

Coinciding with this trend in the decisions of this Court, arbitration has become increasingly sophisticated—and increasingly common—over the last 30 years. This is due to the widespread recognition of the advantages of arbitration in terms of speed, economy, efficiency and confidentiality and the increasing recognition of its fairness as a means of dispute resolution.[12]

The rules and procedures which govern arbitration are designed to ensure fair results.[13] Thus, the AAA's Commercial Arbitration Rules, which are reproduced at Appendix B, provide for neutral arbitrators (Article 12), and provide both for disqualificaton of an arbitrator due to "any circumstances likely to affect impartiality" (Article 19), and for peremptory challenges for any reason (Article 13). Any party may be represented by counsel (Article 22). Pre-hearing conferences and preliminary hearings may be held to arrange for the exchange of information and the production of relevant documents, and to attempt to narrow the issues and expedite the proceedings (Article 10). The Arbitrator can subpoena witnesses and documents for the hearing (Article 31; *see also* 9 U.S.C. § 7), and any party has a right to offer any relevant

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12 As the Court noted in *Mitsubishi*, "it is often a judgment that streamlined proceedings and expeditious results will best serve their needs that causes parties to agree to arbitrate their disputes; it is typically a desire to keep the effort and expense required to resolve a dispute within manageable bounds that prompts them mutually to forego access to judicial remedies." 105 S. Ct. at 3358.

13 Significantly, the SEC has approved the operation and implementation of the arbitral systems for securities cases provided by the National Association of Securities Dealers (the "NASD"), the New York Stock Exchange (the "NYSE") and the American Stock Exchange, *see* SEC Securities Exchange Act Release No. 16390 (Nov. 30, 1979), 18 SEC Docket 1197, and retains general jurisdiction to monitor the fairness of the rules of the NASD and the Exchanges, including the rules governing their arbitration proceedings. *See* 15 U.S.C. § 78s(c). The procedures adopted by the NASD and the Exchanges are generally similar to those of the AAA. This Court has favorably referred to aspects of the AAA's arbitration rules. *See Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145, 149 (1968).

evidence (Article 31), and to require that witnesses testify under oath (Article 27). Any party has a right to have a stenographic record of the proceeding (Article 23),[14] and briefs may be filed (Article 35). A written award is required (Article 42), and, as a matter of practice, the award can contain an explanation of reasons if the parties so request.[15] Arbitration is also designed to be convenient. Thus, the AAA has offices in over 30 cities, *see* AAA, *1985 Annual Report* (1986), and the arbitration may be held in any location to which the parties agree (Article 11).[16]

Moreover, arbitrators are available today who are experienced and fully competent to apply the securities laws.[17] For example, of the 89 arbitrators in 40 recent AAA cases brought by customers against securities firms which were arbitrated to decision, 71 (80%) were lawyers (including 41 attorneys who specialized in securities work and three retired judges), and 16 (18%) were business or accounting executives or financial consultants (the remaining two were college deans or professors).[18] As the *Mitsubishi* Court noted, "adaptability and access to expertise are hallmarks of arbitration. The antici-

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14 Thus, the *Wilko* Court's concern that an award may be made "without a complete record of the[ ] proceedings," 346 U.S. at 436, is unfounded as either party may request such a record.

15 Thus, the *Wilko* Court's concern that an award may be made "without [an] explanation of the[ ] reasons," 346 U.S. at 436, is exaggerated, as the parties may request such an explanation.

16 Similarly, the NYSE has standing panels in 35 cities and NASD in 50 cities, and each will conduct hearings elsewhere upon agreement of the parties. (Communications with the New York City offices of the NYSE and NASD.)

17 Unlike the situation in 1953 when *Wilko* was decided, there is now a fully developed body of case law interpreting the securities laws to which arbitrators can turn for guidance. *See generally* E. Gadsby, *Business Organizations—Securities Regulation* (1986); A. Bromberg & L. Lowenfels, *Securities Fraud and Commodities Fraud* (1985).

18 These were the 40 most recent such cases at the time statistics for this brief were collected. (Materials in files of AAA's Office of Case Administration.)

pated subject matter of the dispute may be taken into account when the arbitrators are appointed and arbitral rules typically provide for the participation of experts." 105 S. Ct. at 3357.

In choosing arbitration, the parties have selected these procedures as the means to resolve their disputes, and the courts should not interfere with that selection. This is especially true because, in addition to satisfying the parties' desire for quick, economical and fair resolution of disputes, arbitration will fully satisfy the federal policies underlying the securities laws. Arbitrators deciding securities claims are obligated to apply the federal securities laws,[19] *Wilko*, *supra*, 346 U.S. at 433-34, and their awards can be vacated for a number of statutory grounds, including "[w]here the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made." 9 U.S.C. § 10(d). Since enforcement of an arbitration award may require confirmation by a court, 9 U.S.C. § 9, the courts will have an "opportunity at the award enforcement stage to ensure that the legitimate interest in the enforcement of the [securities] laws has been addressed." *Mitsubishi*, 105 S. Ct. at 3360.[20] The prospect of judicial review where there is no voluntary compliance with the award helps to assure that the policies embodied in the securities laws will be applied. The *Wilko* Court's suspicion that arbitration would somehow un-

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19 Thus, the situation here is fundamentally different from those cases where this Court has held that because the arbitrators are bound to apply collective bargaining agreements rather than the applicable statutes, arbitration would not be binding for the statutory claims. *See Barrentine v. Arkansas-Best Freight System, Inc.*, 450 U.S. 728, 744 (1981) (Fair Labor Standards Act); *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 56-57 (1974) (Title VII). Here, by contrast, the arbitrators are bound to apply the securities laws, not some separate agreement, *Wilko*, *supra*, and it will be a simple task for the court at the enforcement stage "to ascertain that the [arbitral] tribunal took cognizance of the [securities] claims." *Mitsubishi*, *supra*, 105 S. Ct. at 3360.

20 Copies of any relevant papers in the AAA's possession will be released to any party for use in any proceeding to vacate or enforce the award (Article 46).

dermine those policies is simply unfounded. *See Mitsubishi, supra*, 105 S. Ct. at 3360.[21]

The extensive actual experience with arbitration in the more than thirty years since *Wilko* further compels the conclusion that the time has come to overrule *Wilko*. In 1950, shortly before the *Wilko* decision, the AAA had a total of approximately 1750 arbitrations, fewer than 500 of which were commercial. In 1985, in contrast, the total number of arbitrations had increased more than 25 times to 45,000, over 8,000 of which were commercial.[22] This extensive, nationwide experience with arbitration has shown that it is a fair, efficient and effective means to resolve commercial disputes in general. Thus, in recent years, the virtues and efficacy of arbitration have been widely recognized by courts and commentators. *See, e.g.*, Burger, "Isn't There A Better Way?" 68 Am. Bar Assoc. J. 274 (March 1982); Furnish, "Commercial Arbitration Agreements," *supra*; Meyerowitz, "The Arbitration Alternative," 71 Am. Bar Assoc. J. 78 (Feb. 1985).

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21 It should be noted that insofar the public is concerned, arbitration clauses are likely to be present primarily in individual actions by customers against their brokers, such as the case here. Such clauses are unlikely to be present in a variety of other cases under the securities laws, such as actions by customers (individually or as a class) against issuers or underwriters for allegedly false and misleading disclosures, since there is generally no contractual relationship between customers and issuers or underwriters. *See, e.g., Globus v. Law Research Service, Inc.*, 287 F. Supp. 188 (S.D.N.Y. 1968), *aff'd in part and rev'd in part*, 418 F.2d 1276 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970) (action by purchaser against underwriter under § 12(2) of the Securities Act and § 15(c) of the Exchange Act for material omissions from offering circular); *Weiss v. Tenney Corp.*, 47 F.R.D. 283 (S.D.N.Y. 1969) (action by purchaser against issuer under §§ 11 and 17(a) of the Securities Act and § 10(b) of the Exchange Act for false and misleading statements in the registration statement and prospectus).

22 Materials in files of AAA's Office of Case Administration. *See also* Hirshman, "The Second Arbitration Trilogy: The Federalization of Arbitration Law," 71 Va. L. Rev. 1305, 1305 n.7 (1985); Furnish, "Commercial Arbitration Agreements and the Uniform Commercial Code," 67 Calif. L. Rev. 317, 317-18 & n.1 (1979).

Experience has also shown that arbitration is a fair method of resolving securities disputes in particular. Contrary to the *Wilko* majority's assumptions, arbitration of securities disputes has not proven to be disadvantageous to customers. For example, of 40 cases brought by customers against securities firms recently arbitrated to decision under the auspices of the AAA, 27 (68%) resulted in awards for the customer, in an average amount of over $26,000, including four awards of punitive damages (ranging from $50,000 to $150,000).[23]

That arbitration is a fair and effective method of resolving securities disputes is also confirmed by the experience in other countries. Arbitration clauses are generally enforceable as to securities claims in at least the following countries: Austria, Belgium, Canada, Denmark, France, Germany, Great Britain, Greece, Italy, Japan, Netherlands, Singapore, Spain and Switzerland.[24] *See also Scherk*, *supra*; *Mitsubishi*, *supra*.[25]

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23 Materials in files of AAA's Office of Case Administration. Similarly, NASD statistics show that in 1985, 55% of the public customer cases that were arbitrated to decision awarded damages to the customer. *See* Securities Industry Conference on Arbitration, Report No. 5 at 7 (April 1986).

24 *See* International Council for Commercial Arbitration, *International Handbook on Commercial Arbitration*, Supp. 1 (May 1984) at 5-6 (Austria); 4-5 (Belgium); 5 (Canada); 8-9 (Great Britain); *id.* Supp. 3 (Jan. 1985) at 15-18 (Italy); 8-9 (Switzerland); *id.* Supp. 4 (Nov. 1985) at 7-8 (Greece); *id.* Supp. 5 (May 1986) at 6-7 (Denmark); Doing Business in Europe, Common Market Rep. (CCH) ¶ 27033 (1986) (Netherlands); ¶ 28553 (Spain); International Council for Commercial Arbitration, *Year Book: Commercial Arbitration* Vol. XI (1986) at 29-33 (Singapore); P. Gide, J. Loyrette and P. Nouel, *Le Droit Francais de L'Arbitrage* at 57-75 (1983) (France); O. Glossner, *Commercial Arbitration in the Federal Republic of Germany* (1984) at 2-4, 55 (Germany); Z. Kitagawa, *Doing Business in Japan*, Vol. 7 at ¶ 4.03 (1986) (Japan).

25 As a result of *Scherk* and *Mitsubishi*, if domestic securities and antitrust claims are held to be non-arbitrable, the anomalous result would be that foreign arbitrators would be trusted to apply these federal laws but U.S. arbitrators would not be. With the increasing internationalization of the securities markets, such a distinction would be irrational.

As these developments demonstrate, arbitration has proven to be a fair, efficient and effective means of resolving commercial disputes, including securities disputes.[26] The *Wilko* Court's assumptions to the contrary have not been borne out by experience and are contrary to the express intent of Congress as embodied in the Arbitration Act. *Wilko* remains one of the final remnants of the judicial suspicion of arbitration that Congress intended to eliminate through the Arbitration Act, and that this Court has soundly rejected in its recent decisions on arbitration. This Court should overrule *Wilko* and "correct[ ] a plain misreading of language and history so as to give full respect to the meaning which Congress unmistakably intended the statute to have." *Nye v. United States*, 313 U.S. 33, 51 (1941) (overruling the statutory construction of *Toledo Newspaper Co. v. United States*, 247 U.S. 402 (1918)); *cf. Monell v. Department of Social Services*, 436 U.S. 658 (1978) (overruling the statutory interpretation of *Monroe v. Pape*, 365 U.S. 167 (1961)); *Commissioner v. Estate of Church*, 335 U.S.

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26 There are various other indicia of the increasing acceptance of arbitration. Whereas in 1950 only 20 states had statutes requiring the enforcement of arbitration clauses, today all but five states (Alabama, Mississippi, Nebraska, North Dakota and West Virginia) do. (Materials in files of AAA's Office of General Counsel.) Moreover, case law, including the decisions of this Court discussed above, is increasingly receptive to arbitration. *See generally* DiBenedetto, "An Outline for Arbitration Under the Civil Practice Law and Rules," 48 Alb. L. Rev. 763, 763 (1984) ("Over the years there has been a dramatic increase in both the number of controversies submitted to arbitration and the judiciary's acceptance and encouragement of this alternative means of dispute resolution."); Hirshman, "The Second Arbitration Trilogy," *supra*. State and federal courts have also increasingly adopted arbitration programs to help resolve disputes. Thus some 16 states already have court-annexed arbitration programs in place, and eight more states and the District of Columbia are contemplating implementation; two federal district courts have such programs in place, and such programs are being adopted in eight more districts. Federal Judicial Center, *Settlement Strategies for Federal District Judges*, 43-46 (1986). Moreover, the AAA's role as an impartial administrator of arbitration has been specifically recognized in two federal statutes, three federal regulations, and over 40 state statutes in 21 states and the Virgin Islands. *See* Lawyers' Arbitration Letter, Vol. 5 No. 2 (June 1981 & 1983 Supp.).

632 (1949) (overruling the statutory interpretation of *May v. Heiner*, 281 U.S. 238 (1930)); *Girouard v. United States*, 328 U.S. 61 (1946) (overruling the statutory interpretation of *United States v. Schwimmer*, 279 U.S. 644 (1929)).[27]

C. THE SECOND CIRCUIT'S BROAD "PUBLIC POLICY" EXCEPTION TO THE ENFORCEMENT OF ARBITRATION CLAUSES CONFLICTS WITH THE ARBITRATION ACT AND THE RECENT DECISIONS OF THIS COURT

In holding that RICO claims are not arbitrable,[28] the Second Circuit relied upon its doctrine, announced in cases such as *American Safety Equipment Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) (holding arbitration agreements unenforceable as to antitrust disputes), that the Arbitration Act is "inappropriate[ ] . . . when strong public policy considerations are involved." *McMahon*, *supra*, 788 F.2d at 98.

The Second Circuit's "public policy" exception is improper judicial legislation pure and simple. Nothing in the Arbitration Act permits such an exception. Rather, as this Court explained in *Mitsubishi*, arbitration agreements must be enforced as to statutory claims unless there is an explicit statement of Congressional intent to prevent arbitration. In holding RICO claims non-arbitrable for public policy reasons, "the *McMahon* court paid too little deference to the Supreme Court's decision in *Mitsubishi*." *Jacobson v. Merrill Lynch, Pierce,*

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27 Since arbitration clauses should be held to be enforceable as to Securities Act claims, which are based on express statutory rights, *a fortiori* they should be enforced as to claims under the Exchange Act, which are based on implied rights. Since Congress did not expressly create private rights of action under the Exchange Act, it can hardly have intended to preclude arbitration of them. *Amicus* adopts petitioners' arguments on this point.

28 There is nothing in RICO or its legislative history that suggests Congress intended to preclude arbitration of such claims. *Amicus* adopts petitioners' arguments on this point.

Fenner & Smith, Inc., 797 F.2d 1197, 1202 (3d Cir. 1986); *see also Mayaja, Inc. v. Shearson Lehman Brothers, Inc.*, No. 85-2762, slip op. at 13-14 n.6 (5th Cir. Oct. 24, 1986). After *Mitsubishi*,

> [d]etermining statutory claims to be nonarbitrable on the basis of some judicially recognized public policy rather than as a matter of statutory interpretation is no longer permissible.

Jacobson, *supra*, 797 F.2d at 1202; *see also Mayaja*, *supra*, slip op. at 13-14 n.6. Accordingly, although it did not need to reach the issue, the *Mitsubishi* Court noted its "skepticism of certain aspects of the *American Safety* doctrine." 105 S. Ct. at 3357. As the Fifth Circuit has stated, "*Mitsubishi* rejected so much of *American Safety*'s reasoning it is difficult to say what is left of the opinion to rely on." *Mayaja*, *supra*, slip op. at 14 n.6.

The so-called "public policy" exception to the Arbitration Act is unwarranted and unwise. It flies in the face of the express language of the Arbitration Act and of this Court's decision in *Mitsubishi*. It should be rejected.[29]

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29 The exception is all the more improper because there is no rational way to limit it. Presumably, all statutes reflect a Congressional expression of public policy; otherwise, Congress would not have enacted the legislation. The Second Circuit has not articulated any way to distinguish those statutes for which arbitration would be precluded under its public policy exception from those for which it would be allowed.

Rather, this Court articulated the proper test in *Mitsubishi*. Since Congress established the rule that arbitration clauses should be enforced, it requires Congress to create an exception. Unless Congress has expressly created such an exception, arbitration clauses must be enforced, and courts should not be permitted to substitute their view of public policy for Congress's.

CONCLUSION

The Federal Arbitration Act, the recent decisions of this Court, and decades of extensive experience with arbitration, all require the same conclusion: contractual agreements whereby parties select arbitration for the resolution of commercial disputes—including disputes based on statutory claims—should be enforced absent an express statement of Congressional intent to the contrary. Since nothing in the Securities Act, the Exchange Act, or RICO—or in the legislative history of those statutes—evidences a Congressional intent to preclude arbitration, arbitration clauses should be enforced as to claims under all three statutes.

Wilko v. Swan, which held arbitration clauses unenforceable as to Securities Act disputes, should be overruled because it was based on a suspicion of arbitration subsequently acknowledged by this Court—and proven by experience—to be unfounded, rather than on evidence of the intent of Congress. Disputes under the Exchange Act and RICO are even more clearly arbitrable. This Court should reject the broad "public policy" exception to arbitration articulated by the court below, since it is contrary to the express language of the Arbitration Act and the decisions of this Court.

Thus, the Second Circuit's decision should be reversed as to the arbitrability of Exchange Act and RICO claims, and, in order to provide clarity in this important area of the law, *Wilko v. Swan* should be overruled.

Dated: New York, New York
November 20, 1986

Respectfully submitted,

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APPENDICES

APPENDIX A

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Administrative Procedure Act

5 U.S.C. § 706(2)(A), (C):

> To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—
>
> * * *
>
> (2) hold unlawful and set aside agency action, findings, and conclusions found to be—
>
> (A) arbitrary, capricious, and abuse of discretion, or otherwise not in accordance with law;
>
> * * *
>
> (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;
>
> * * *

United States Arbitration Act

9 U.S.C. § 2:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 7:

> The arbitrators selected either as prescribed in this title or otherwise, or a majority of them, may summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case. The fees for such attendance shall be the same as the fees of witnesses before masters of the United States courts. Said summons shall issue in the name of the arbitrator or arbitrators, or a majority of them, and shall be signed by the arbitrators, or a majority of them, and shall be directed to the said person and shall be served in the same manner as subpoenas to appear and testify before the court; if any person or persons so summoned to testify shall refuse or neglect to obey said summons, upon petition the United States district court for the district in which such arbitrators, or a majority of them, are sitting may compel the attendance of such person or persons before said arbitrator or arbitrators, or punish said person or persons for contempt in the same manner provided by law for securing the attendance of witnesses or their punishment for neglect or refusal to attend in the courts of the United States.

9 U.S.C. § 9:

> If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title. If no court is specified in the agreement of the parties, then such application may be made to the United States court in and for the district within which such award was made. Notice of the applica-

tion shall be served upon the adverse party, and thereupon the court shall have jurisdiction of such party as though he had appeared generally in the proceeding. If the adverse party is a resident of the district within which the award was made, such service shall be made upon the adverse party or his attorney as prescribed by law for service of notice of motion in an action in the same court. If the adverse party shall be a nonresident, then the notice of the application shall be served by the marshal of any district within which the adverse party may be found in like manner as other process of the court.

9 U.S.C. § 10(d):

In either of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

* * *

(d) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

* * *

Securities Act of 1933

15 U.S.C. § 77n:

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

Securities Exchange Act of 1934

15 U.S.C. § 78s(c):

(c) The Commission, by rule, may abrogate, add to, and delete from (hereinafter in this subsection collectively

referred to as "amend") the rules of a self-regulatory organization (other than a registered clearing agency) as the Commission deems necessary or appropriate to insure the fair administration of the self-regulatory organization, to conform its rules to requirements of this chapter and the rules and regulations thereunder applicable to such organization, or otherwise in furtherance of the purposes of this chapter, in the following manner:

(1) The Commission shall notify the self-regulatory organization and publish notice of the proposed rulemaking in the Federal Register. The notice shall include the text of the proposed amendment to the rules of the self-regulatory organization and a statement of the Commission's reasons, including any pertinent facts, for commencing such proposed rulemaking.

(2) The Commission shall give interested persons an opportunity for the oral presentation of data, views, and arguments, in addition to an opportunity to make written submissions. A transcript shall be kept of any oral presentation.

(3) A rule adopted pursuant to this subsection shall incorporate the text of the amendment to the rules of the self-regulatory organization and a statement of the Commission's basis for and purpose in so amending such rules. This statement shall include an identification of any facts on which the Commission considers its determination so to amend the rules of the self-regulatory agency to be based, including the reasons for the Commission's conclusions as to any of such facts which were disputed in the rulemaking.

(4)(A) Except as provided in paragraphs (1) through (3) of this subsection, rulemaking under this subsection shall be in accordance with the procedures specified in section 553 of Title 5 for rulemaking not on the record.

(B) Nothing in this subsection shall be construed to impair or limit the Commission's power to make, or to modify or alter the procedures the Commission may follow in making, rules and regulations pursuant to any other authority under this chapter.

(C) Any amendment to the rules of a self-regulatory organization made by the Commission pursuant to this subsection shall be considered for all purposes of this chapter to be part of the rules of such self-regulatory organization and shall not be considered to be a rule of the Commission.

APPENDIX B

AMERICAN ARBITRATION ASSOCIATION
COMMERCIAL ARBITRATION RULES

TABLE OF CONTENTS

		Page*
1.	Agreement of Parties	9a
2.	Name of Tribunal	9a
3.	Administrator	9a
4.	Delegation of Duties	9a
5.	National Panel of Arbitrators	9a
6.	Office of Tribunal	9a
7.	Initiation under an Arbitration Provision in a Contract	9a
8.	Change of Claim	10a
9.	Initiation under a Submission	10a
10.	Pre-hearing Conference and Preliminary Hearing	11a
11.	Fixing of Locale	11a
12.	Qualifications of Arbitrator	11a
13.	Appointment from Panel	11a
14.	Direct Appointment by Parties	12a
15.	Appointment of Neutral Arbitrator by Party-Appointed Arbitrators	13a
16.	Nationality of Arbitrator in International Arbitration	13a
17.	Number of Arbitrators	13a

* Page references correspond to this appendix.

PAGE

18. Notice to Arbitrator of Appointment 13a
19. Disclosure and Challenge Procedure 14a
20. Vacancies 14a
21. Time and Place 14a
22. Representation by Counsel 14a
23. Stenographic Record 14a
24. Interpreter 15a
25. Attendance at Hearings 15a
26. Adjournments 15a
27. Oaths 15a
28. Majority Decision 15a
29. Order of Proceedings 15a
30. Arbitration in the Absence of a Party 16a
31. Evidence 16a
32. Evidence by Affidavit and Filing of Documents .. 16a
33. Inspection or Investigation 17a
34. Conservation of Property 17a
35. Closing of Hearings 17a
36. Reopening of Hearings 17a
37. Waiver of Oral Hearings 18a
38. Waiver of Rules 18a
39. Extensions of Time 18a
40. Communication with Arbitrator and Serving of Notice 18a
41. Time of Award 19a

PAGE

42. Form of Award 19a
43. Scope of Award 19a
44. Award upon Settlement 19a
45. Delivery of Award to Parties 19a
46. Release of Documents for Judicial Proceedings .. 19a
47. Applications to Court and Exclusion of Liability 20a
48. Administrative Fees 20a
49. Fee when Oral Hearings Are Waived 20a
50. Expenses 20a
51. Arbitrator's Fee 21a
52. Deposits 21a
53. Interpretation and Application of Rules 21a

EXPEDITED PROCEDURES 22a

54. Notice by Telephone 22a
55. Appointment and Qualifications of Arbitrators .. 22a
56. Time and Place of Hearing 22a
57. The Hearing 22a
58. Time of Award 22a

ADMINISTRATIVE FEE SCHEDULE 23a

OTHER SERVICE CHARGES 23a

REFUND SCHEDULE 24a

COMMERCIAL ARBITRATION RULES

1. *Agreement of Parties.* The parties shall be deemed to have made these Rules a part of their arbitration agreement whenever they have provided for arbitration by the American Arbitration Association or under its Rules. These Rules and any amendment thereof shall apply in the form obtaining at the time the arbitration is initiated.

2. *Name of Tribunal.* Any Tribunal constituted by the parties for the settlement of their dispute under these Rules shall be called the Commercial Arbitration Tribunal.

3. *Administrator.* When parties agree to arbitrate under these Rules, or when they provide for arbitration by the American Arbitration Association and an arbitration is initiated thereunder, they thereby constitute the AAA the administrator of the arbitration. The authority and obligations of the administrator are prescribed in the agreement of the parties and in these Rules.

4. *Delegation of Duties.* The duties of the AAA under these Rules may be carried out through Tribunal Administrators, or such other officers or committees as the AAA may direct.

5. *National Panel of Arbitrators.* The AAA shall establish and maintain a National Panel of Arbitrators and shall appoint Arbitrators therefrom as hereinafter provided.

6. *Office of Tribunal.* The general office of a Tribunal is the headquarters of the AAA, which may, however, assign the administration of an arbitration to any of its Regional Offices.

7. *Initiation under an Arbitration Provision in a Contract.* Arbitration under an arbitration provision in a contract may be initiated in the following manner:

> (a) The initiating party shall give notice to the other party of its intention to arbitrate (Demand), which notice shall contain a statement setting forth the nature of the dispute, the amount involved, if any, the remedy sought, and

(b) By filing at any Regional Office of the AAA three copies of said notice, together with three copies of the arbitration provisions of the contract, together with the appropriate administrative fee as provided in the Administrative Fee Schedule. The AAA shall give notice of such filing to the other party. If so desired, the party upon whom the Demand for Arbitration is made may file an answering statement in duplicate with the AAA within seven days after notice from the AAA, in which event said party shall simultaneously send a copy of the answer to the other party. If a counterclaim is asserted it shall contain a statement setting forth the nature of the counterclaim, the amount involved, if any, and the remedy sought. If a monetary claim is made in the answer the appropriate fee provided in the Fee Schedule shall be forwarded to the AAA with the answer. If no answer is filed within the stated time, it will be assumed that the claim is denied. Failure to file an answer shall not operate to delay the arbitration.

Unless the AAA in its discretion determines otherwise, the Expedited Procedures of Commercial Arbitration shall be applied in any case where the total claim of any party does not exceed $15,000, exclusive of interest and arbitration costs. The Expedited Procedures shall be applied as described in Sections 54 through 58 of these Rules.

8. *Change of Claim*. After filing of the claim, if either party desires to make any new or different claim, such claim shall be made in writing and filed with the AAA, and a copy thereof shall be mailed to the other party, who shall have a period of seven days from the date of such mailing within which to file an answer with the AAA. After the Arbitrator is appointed, however, no new or different claim may be submitted except with the Arbitrator's consent.

9. *Initiation under a Submission*. Parties to any existing dispute may commence an arbitration under these Rules by filing at any Regional Office two copies of a written agreement

to arbitrate under these Rules (Submission), signed by the parties. It shall contain a statement of the matter in dispute, the amount of money involved, if any, and the remedy sought, together with the appropriate administrative fee as provided in the Fee Schedule.

10. *Pre-hearing Conference and Preliminary Hearing.* At the request of the parties or at the discretion of the AAA, a pre-hearing conference with the administrator and the parties will be scheduled in appropriate cases to arrange for an exchange of information and the stipulation to uncontested facts to expedite the arbitration proceedings.

In large or complex cases, at the discretion of the Arbitrator(s) or the AAA, a preliminary hearing will be scheduled with the Arbitrator(s) and the parties to arrange for the production of relevant documents and other evidence, to identify witnesses to be called, to schedule further hearings, and to consider any other matters which will expedite the arbitration proceedings.

11. *Fixing of Locale.* The parties may mutually agree on the locale where the arbitration is to be held. If the locale is not designated within seven days from the date of filing the Demand or Submission, the AAA shall have power to determine the locale. Its decision shall be final and binding. If any party requests that the hearing be held in a specific locale and the other party files no objection thereto within seven days after notice of the request, the locale shall be the one requested.

12. *Qualifications of Arbitrator.* Any Arbitrator appointed pursuant to Section 13 or Section 15 shall be neutral, subject to disqualification for the reasons specified in Section 19. If the agreement of the parties names an Arbitrator or specifies any other method of appointing an Arbitrator, or if the parties specifically agree in writing, such Arbitrator shall not be subject to disqualification for said reasons.

13. *Appointment from Panel.* If the parties have not appointed an Arbitrator and have not provided any other method

of appointment, the Arbitrator shall be appointed in the following manner: Immediately after the filing of the Demand or Submission, the AAA shall submit simultaneously to each party to the dispute an identical list of names of persons chosen from the Panel. Each party to the dispute shall have seven days from the mailing date in which to cross off any names objected to, number the remaining names to indicate the order of preference, and return the list to the AAA. If a party does not return the list within the time specified, all persons named therein shall be deemed acceptable. From among the persons who have been approved on both lists, and in accordance with the designated order of mutual preference, the AAA shall invite the acceptance of an Arbitrator to serve. If the parties fail to agree upon any of the persons named, or if acceptable Arbitrators are unable to act, or if for any other reason the appointment cannot be made from the submitted lists, the AAA shall have the power to make the appointment from among other members of the Panel without the submission of any additional list.

14. *Direct Appointment by Parties.* If the agreement of the parties names an Arbitrator or specifies a method of appointing an Arbitrator, that designation or method shall be followed. The notice of appointment, with name and address of the appointing party, shall be filed with the AAA by the appointing party. Upon the request of any such appointing party, the AAA shall submit a list of members of the Panel from which the party may, if it so desires, make the appointment.

If the agreement specifies a period of time within which an Arbitrator shall be appointed, and any party fails to make such appointment within that period, the AAA shall make the appointment.

If no period of time is specified in the agreement, the AAA shall notify the parties to make the appointment and if within seven days thereafter such Arbitrator has not been so appointed, the AAA shall make the appointment.

15. *Appointment of Neutral Arbitrator by Party-Appointed Arbitrators.* If the parties have appointed their Arbitrators or if either or both of them have been appointed as provided in Section 14, and have authorized such Arbitrators to appoint a neutral Arbitrator within a specified time and no appointment is made within such time or any agreed extension thereof, the AAA shall appoint a neutral Arbitrator who shall act as Chairman.

If no period of time is specified for appointment of the neutral Arbitrator and the parties do not make the appointment within seven days from the date of the appointment of the last party-appointed Arbitrator, the AAA shall appoint such neutral Arbitrator, who shall act as Chairman.

If the parties have agreed that their Arbitrators shall appoint the neutral Arbitrator from the Panel, the AAA shall furnish to the party-appointed Arbitrators, in the manner prescribed in Section 13, a list selected from the Panel, and the appointment of the neutral Arbitrator shall be made as prescribed in such Section.

16. *Nationality of Arbitrator in International Arbitration.* If one of the parties is a national or resident of a country other than the United States, the sole Arbitrator or the neutral Arbitrator shall, upon the request of either party, be appointed from among the nationals of a country other than that of any of the parties.

17. *Number of Arbitrators.* If the arbitration agreement does not specify the number of Arbitrators, the dispute shall be heard and determined by one Arbitrator, unless the AAA, in its discretion, directs that a greater number of Arbitrators be appointed.

18. *Notice to Arbitrator of Appointment.* Notice of the appointment of the neutral Arbitrator, whether appointed by the parties or by the AAA, shall be mailed to the Arbitrator by the AAA, together with a copy of these Rules, and the signed acceptance of the Arbitrator shall be filed prior to the opening of the first hearing.

19. *Disclosure and Challenge Procedure.* A person appointed as neutral Arbitrator shall disclose to the AAA any circumstances likely to affect impartiality, including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their counsel. Upon receipt of such information from such Arbitrator or other source, the AAA shall communicate such information to the parties, and, if it deems it appropriate to do so, to the Arbitrator and others. Thereafter, the AAA shall determine whether the Arbitrator should be disqualified and shall inform the parties of its decision, which shall be conclusive.

20. *Vacancies.* If any Arbitrator should resign, die, withdraw, refuse, be disqualified or be unable to perform the duties of the office, the AAA may, on proof satisfactory to it, declare the office vacant. Vacancies shall be filled in accordance with the applicable provisions of these Rules.

In the event of a vacancy in a panel of neutral Arbitrators, the remaining Arbitrator or Arbitrators may continue with the hearing and determination of the controversy, unless the parties agree otherwise.

21. *Time and Place.* The Arbitrator shall fix the time and place for each hearing. The AAA shall mail to each party notice thereof at least five days in advance, unless the parties by mutual agreement waive such notice or modify the terms thereof.

22. *Representation by Counsel.* Any party may be represented by counsel. A party intending to be so represented shall notify the other party and the AAA of the name and address of counsel at least three days prior to the date set for the hearing at which counsel is first to appear. When an arbitration is initiated by counsel, or where an attorney replies for the other party, such notice is deemed to have been given.

23. *Stenographic Record.* Any party wishing a stenographic record shall make such arrangements directly with the stenographer and shall notify the other parties of such arrangements in advance of the hearing. The requesting party or parties shall pay the cost of such record.

24. *Interpreter.* Any party wishing an interpreter shall make all arrangements directly with an interpreter and shall assume the costs of such service.

25. *Attendance at Hearings.* The Arbitrator shall maintain the privacy of the hearings unless the law provides to the contrary. Any person having a direct interest in the arbitration is entitled to attend hearings. The Arbitrator shall otherwise have the power to require the exclusion of any witness, other than a party or other essential person, during the testimony of any other witness. It shall be discretionary with the Arbitrator to determine the propriety of the attendance of any other person.

26. *Adjournments.* The Arbitrator may take adjournments upon the request of a party or upon the Arbitrator's own initiative and shall take such adjournment when all of the parties agree thereto.

27. *Oaths.* Before proceeding with the first hearing or with the examination of the file, each Arbitrator may take an oath of office, and if required by law, shall do so. The Arbitrator has discretion to require witnesses to testify under oath administered by any duly qualified person or, if required by law or demanded by either party, shall do so.

28. *Majority Decision.* Whenever there is more than one Arbitrator, all decisions of the Arbitrators must be by at least a majority. The award must also be made by at least a majority unless the concurrence of all is expressly required by the arbitration agreement or by law.

29. *Order of Proceedings.* A hearing shall be opened by the filing of the oath of the Arbitrator, where required, and by the recording of the place, time and date of the hearing, the presence of the Arbitrator and parties, and counsel, if any, and by the receipt by the Arbitrator of the statement of the claim and answer, if any.

The Arbitrator may, at the beginning of the hearing, ask for statements clarifying the issues involved.

The complaining party shall then present its claim and proofs and its witnesses, who shall submit to questions or other examination. The defending party shall then present its defense and proofs and its witnesses, who shall submit to questions or other examination. The Arbitrator has discretion to vary this procedure but shall afford full and equal opportunity to all parties for the presentation of any material or relevant proofs.

Exhibits, when offered by either party, may be received in evidence by the Arbitrator.

The names and addresses of all witnesses and exhibits in order received shall be made a part of the record.

30. *Arbitration in the Absence of a Party.* Unless the law provides to the contrary, the arbitration may proceed in the absence of any party which, after due notice, fails to be present or fails to obtain an adjournment. An award shall not be made solely on the default of a party. The Arbitrator shall require the party who is present to submit such evidence as the Arbitrator may require for the making of an award.

31. *Evidence.* The parties may offer such evidence as is relevant and material to the dispute and shall produce such additional evidence as the Arbitrator may deem necessary to an understanding and determination of the dispute. An Arbitrator authorized by law to subpoena witnesses or documents may do so upon the request of any party, or independently.

The Arbitrator shall be the judge of the relevance and materiality of the evidence offered and conformity to legal rules of evidence shall not be necessary. All evidence shall be taken in the presence of all the Arbitrators and all of the parties, except where any of the parties is absent in default or has waived the right to be present.

32. *Evidence by Affidavit and Filing of Documents.* The Arbitrator shall receive and consider the evidence of witnesses by affidavit, but shall give it only such weight as the Arbitrator deems it entitled to after consideration of any objections made to its admission.

All documents not filed with the Arbitrator at the hearing, but arranged for at the hearing or subsequently by agreement of the parties, shall be filed with the AAA for transmission to the Arbitrator. All parties shall be afforded opportunity to examine such documents.

33. *Inspection or Investigation.* Whenever the Arbitrator deems it necessary to make an inspection or investigation in connection with the arbitration, the Arbitrator shall direct the AAA to advise the parties of such intention. The Arbitrator shall set the time and the AAA shall notify the parties thereof. Any party who so desires may be present at such inspection or investigation. In the event that one or both parties are not present at the inspection or investigation, the Arbitrator shall make a verbal or written report to the parties and afford them an opportunity to comment.

34. *Conservation of Property.* The Arbitrator may issue such orders as may be deemed necessary to safeguard the property which is the subject matter of the arbitration without prejudice to the rights of the parties or to the final determination of the dispute.

35. *Closing of Hearings.* The Arbitrator shall specifically inquire of all parties whether they have any further proofs to offer or witnesses to be heard. Upon receiving negative replies, or if satisfied that the record is complete, the Arbitrator shall declare the hearings closed and a minute thereof shall be recorded. If briefs are to be filed, the hearing shall be declared closed as of the final date set by the Arbitrator for the receipt of briefs. If documents are to be filed as provided for in Section 32 and the date set for their receipt is later than that set for the receipt of briefs, the later date shall be the date of closing the hearings. The time limit within which the Arbitrator is required to make the award shall commence to run, in the absence of other agreements by the parties, upon the closing of the hearings.

36. *Reopening of Hearings.* The hearings may be reopened on the Arbitrator's own motion, or upon application of a

party, at any time before the award is made. If reopening the hearings would prevent the making of the award within the specific time agreed upon by the parties in the contract out of which the controversy has arisen, the matter may not be reopened, unless the parties agree upon the extension of such time limit. When no specific date is fixed in the contract, the Arbitrator may reopen the hearings, and the Arbitrator shall have thirty days from the closing of the reopened hearings within which to make an award.

37. *Waiver of Oral Hearings.* The parties may provide, by written agreement, for the waiver of oral hearings. If the parties are unable to agree as to the procedure, the AAA shall specify a fair and equitable procedure.

38. *Waiver of Rules.* Any party who proceeds with the arbitration after knowledge that any provision or requirement of these Rules has not been complied with and who fails to state objection thereto in writing, shall be deemed to have waived the right to object.

39. *Extensions of Time.* The parties may modify any period of time by mutual agreement. The AAA for good cause may extend any period of time established by these Rules, except the time for making the award. The AAA shall notify the parties of any such extension of time and its reason therefor.

40. *Communication with Arbitrator and Serving of Notice.*

(a) There shall be no communication between the parties and a neutral Arbitrator other than at oral hearings. Any other oral or written communications from the parties to the Arbitrator shall be directed to the AAA for transmittal to the Arbitrator.

(b) Each party to an agreement which provides for arbitration under these Rules shall be deemed to have consented that any papers, notices or process necessary or proper for the initiation or continuation of an arbitration under these Rules and for any court action in connection therewith or for the entry of judgment on any award made thereunder may be

served upon such party by mail addressed to such party or its attorney at its last known address or by personal service, within or without the state wherein the arbitration is to be held (whether such party be within or without the United States of America), provided that reasonable opportunity to be heard with regard thereto has been granted such party.

41. *Time of Award.* The award shall be made promptly by the Arbitrator and, unless otherwise agreed by the parties, or specified by law, no later than thirty days from the date of closing the hearings, or if oral hearings have been waived, from the date of transmitting the final statements and proofs to the Arbitrator.

42. *Form of Award.* The award shall be in writing and shall be signed either by the sole Arbitrator or by at least a majority if there be more than one. It shall be executed in the manner required by law.

43. *Scope of Award.* The Arbitrator may grant any remedy or relief which the Arbitrator deems just and equitable and within the scope of the agreement of the parties, including, but not limited to, specific performance of a contract. The Arbitrator, in the award, shall assess arbitration fees and expenses in favor of any party and, in the event any administrative fees or expenses are due the AAA, in favor of the AAA.

44. *Award upon Settlement.* If the parties settle their dispute during the course of the arbitration, the Arbitrator, upon their request, may set forth the terms of the agreed settlement in an award.

45. *Delivery of Award to Parties.* Parties shall accept as legal delivery of the award the placing of the award or a true copy thereof in the mail by the AAA, addressed to such party at its last known address or to its attorney, or personal service of the award, or the filing of the award in any manner which may be prescribed by law.

46. *Release of Documents for Judicial Proceedings.* The AAA shall, upon the written request of a party, furnish to such

party, at its expense, certified facsimiles of any papers in the AAA's possession that may be required in judicial proceedings relating to the arbitration.

47. *Applications to Court and Exclusion of Liability.*

(a) No judicial proceedings by a party relating to the subject matter of the arbitration shall be deemed a waiver of the party's right to arbitrate.

(b) Neither the AAA nor any Arbitrator in a proceeding under these Rules is a necessary party in judicial proceedings relating to the arbitration.

(c) Parties to these Rules shall be deemed to have consented that judgment upon the arbitration award may be entered in any Federal or State Court having jurisdiction thereof.

(d) Neither the AAA nor any Arbitrator shall be liable to any party for any act or omission in connection with any arbitration conducted under these Rules.

48. *Administrative Fees.* As a not-for-profit organization, the AAA shall prescribe an Administrative Fee Schedule and a Refund Schedule to compensate it for the cost of providing administrative services. The schedule in effect at the time of filing or the time of refund shall be applicable.

The administrative fees shall be advanced by the initiating party or parties, subject to final apportionment by the Arbitrator in the award.

When a matter is withdrawn or settled, the refund shall be made in accordance with the Refund Schedule.

The AAA, in the event of extreme hardship on the part of any party, may defer or reduce the administrative fee.

49. *Fee when Oral Hearings Are Waived.* When all oral hearings are waived under Section 37, the Administrative Fee Schedule shall apply.

50. *Expenses.* The expenses of witnesses for either side shall be paid by the party producing such witnesses.

The cost of the stenographic record, if any is made, and all transcripts thereof, shall be prorated equally among all parties ordering copies unless they shall otherwise agree and shall be paid for by the responsible parties directly to the reporting agency.

All other expenses of the arbitration, including required traveling and other expenses of the Arbitrator and of AAA representatives, and the expenses of any witness or the cost of any proofs produced at the direct request of the Arbitrator, shall be borne equally by the parties, unless they agree otherwise, or unless the Arbitrator, in the award, assesses such expenses or any part thereof against any specified party or parties.

51. *Arbitrator's Fee*. Members of the National Panel of Arbitrators who serve as neutral Arbitrators do so in most cases without fee. In prolonged or in special cases the parties may agree to pay a fee, or the AAA may determine that payment of a fee by the parties is appropriate and may establish a reasonable amount, taking into account the extent of service by the Arbitrator and other relevant circumstances of the case. When neutral Arbitrators are to be paid, the arrangements for compensation shall be made through the AAA and not directly between the parties and the Arbitrators.

52. *Deposits*. The AAA may require the parties to deposit in advance such sums of money as it deems necessary to defray the expense of the arbitration, including the Arbitrator's fee, if any, and shall render an accounting to the parties and return any unexpended balance.

53. *Interpretation and Application of Rules*. The Arbitrator shall interpret and apply these Rules insofar as they relate to the Arbitrator's powers and duties. When there is more than one Arbitrator and a difference arises among them concerning the meaning or application of any such Rules, it shall be decided by a majority vote. If that is unobtainable, either an Arbitrator or a party may refer the question to the AAA for final decision. All other Rules shall be interpreted and applied by the AAA.

EXPEDITED PROCEDURES

54. *Notice by Telephone.* The parties shall accept all notices from the AAA by telephone. Such notices by the AAA shall subsequently be confirmed in writing to the parties. Notwithstanding the failure to confirm in writing any notice or objection hereunder, the proceeding shall nonetheless be valid if notice has, in fact, been given by telephone.

55. *Appointment and Qualifications of Arbitrators.* The AAA shall submit simultaneously to each party to the dispute an identical list of five members of the Commercial Arbitration Panel of Arbitrators from which one Arbitrator shall be appointed. Each party shall have the right to strike two names from the list on a peremptory basis. The list is returnable to the AAA within 10 days from the date of mailing. If for any reasons the appointment cannot be made from the list, the AAA shall have the authority to make the appointment from among other members of the Panel without the submission of additional lists. Such appointment shall be subject to disqualification for the reasons specified in Section 19. The parties shall be given notice by telephone by the AAA of the appointment of the Arbitrator. The parties shall notify the AAA, by telephone, within seven (7) days of any objections to the Arbitrators appointed. Any objection by a party to such Arbitrator shall be confirmed in writing to the AAA with a copy to the other party(ies).

56. *Time and Place of Hearing.* The Arbitrator shall fix the date, time and place of the hearing. The AAA will notify the parties by telephone, seven (7) days in advance of the hearing date. Formal Notice of Hearing will be sent by the AAA to the parties.

57. *The Hearing.* Generally, the hearing shall be completed within one day. The Arbitrator, for good cause shown, may schedule an additional hearing to be held within five days.

58. *Time of Award.* Unless otherwise agreed to by the parties, the award shall be rendered not later than five (5) business days from the date of the closing of the hearing.

ADMINISTRATIVE FEE SCHEDULE

The administrative fee of the AAA is based upon the amount of each claim and counterclaim as disclosed when the claim and counterclaim are filed, and is due and payable at the time of filing.

Amount of Claim	*Fee*
$1 to $20,000	3% (minimum $200)
$20,000 to $40,000	$600, plus 2% of excess over $20,000
$40,000 to $80,000	$1000, plus 1% of excess over $40,000
$80,000 to $160,000	$1400, plus 1/2% of excess over $80,000
$160,000 to $5,000,000	$1800, plus 1/4% of excess over $160,000

Where the claim or counterclaim exceeds $5 million, an appropriate fee will be determined by the AAA.

When no amount can be stated at the time of filing, the administrative fee is $500, subject to adjustment in accordance with the above schedule as soon as an amount can be disclosed.

In those claims and counterclaims which are not for a monetary amount, an appropriate administrative fee will be determined by the AAA.

If there are more than two parties represented in the arbitration, an additional 10% of the initiating fee will be due for each additional represented party.

OTHER SERVICE CHARGES

$50 payable by a party causing an adjournment of any scheduled hearing;

$100 payable by a party causing a second or additional adjournment of any scheduled hearing;

$50 payable by each party for each hearing after the first hearing which is either clerked by the AAA or held in a hearing room provided by the AAA.

REFUND SCHEDULE

If the AAA is notified that a case has been settled or withdrawn before a list of Arbitrators has been sent out, all the fee in excess of $200 will be refunded.

If the AAA is notified that a case has been settled or withdrawn before the original due date for the return of the first list, two-thirds of the fee in excess of $200 will be refunded.

If the AAA is notified that a case is settled or withdrawn during or following a pre-hearing conference or at least 48 hours before the date and the time set for the first hearing, one-third of the fee in excess of $200 will be refunded.

No. 86-44 (9)

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS, INC., and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN, THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN, THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN, and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF *AMICI CURIAE* IN SUPPORT OF THE PETITIONERS

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TABLE OF CONTENTS

PAGE

Table of Authorities iii

Brief *Amici Curiae* 1

Preliminary Statement 1

Interest of *Amici Curiae* 2

Summary of Argument 3

ARGUMENT

I. Arbitration is Favored as an Efficient and Widely Accepted Means of Resolving Broker-Customer Disputes in the Securities Industry 5

II. Congress did not Repeal the United States Arbitration Act With Respect to Claims Brought Under the Racketeer Influenced and Corrupt Organizations Act 12

III. The Rule of *Wilko* v. *Swan* Should not be Extended to the Implied Right of Action Under Section 10(b) of the Securities Exchange Act of 1934 15

CONCLUSION 20

TABLE OF AUTHORITIES

Cases: PAGE

Allen v. *McCurry*, 449 U.S. 90 (1980) 12

American Safety Equipment Corp. v. *J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) 13n

AVC Nederland B.V. v. *Atrium Inv. Partnership*, 740 F.2d 148 (2d Cir. 1984) 8

Axelrod & Co. v. *Kordich, Victor & Neufeld*, 320 F. Supp. 193 (S.D.N.Y. 1970), *aff'd*, 451 F.2d 838 (2d Cir. 1971) 7

Badart v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 797 F.2d 775 (9th Cir. 1986), *petition for cert. filed*, 55 U.S.L.W. 3317 (U.S. Oct. 10, 1986) (No. 86-591) 3n

Blue Chip Stamps v. *Manor Drug Stores*, 421 U.S. 723 (1975) 17

Brown v. *Gilligan, Will & Co.*, 287 F. Supp. 766 (S.D.N.Y. 1968) 7

Bustamente v. *Rotan Mosle, Inc.*, No. 86-2300 slip op. (5th Cir. Oct. 18, 1986) 15n

Cannon v. *University of Chicago*, 441 U.S. 677 (1979) 18n

Conover v. *Dean Witter Reynolds, Inc.*, 794 F.2d 520 (9th Cir. 1986), *petition for cert. filed*, 55 U.S.L.W. 3159 (U.S. Aug. 29, 1986) (No. 86-321) 3n, 15n, 18, 19

Cort v. *Ash*, 422 U.S. 66 (1975) 17n, 18n

Dean Witter Reynolds Inc. v. *Byrd*, 470 U.S. 213 (1985) .....*passim*

Ernst & Ernst v. *Hochfelder*, 425 U.S. 185 (1976) 17

Fischman v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951) 18n

PAGE

Gardner v. *Shearson, Hammill & Co.*, 433 F.2d 367 (5th Cir. 1970), *cert. denied*, 401 U.S. 978 (1971) 8

Girouard v. *United States*, 328 U.S. 61 (1946)..... 17n

Herman & MacLean v. *Huddleston*, 459 U.S. 375 (1983)...17, 17n

Intre Sport Ltd. v. *Kidder Peabody & Co. Incorporated*, 625 F. Supp. 1303 (S.D.N.Y.), *aff'd*, 795 F.2d 1004 (2d Cir. 1986), *petition for cert. filed*, 55 U.S.L.W. 3023 (U.S. Jul. 16, 1986) (No. 86-40)..... 3n

Jacobson v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 797 F.2d 1197 (3d Cir. 1986), *petition for cert. filed*, 55 U.S.L.W. 3259 (U.S. Sept. 25, 1986) (No. 86-487).....3n, 12n, 14, 15n

Kaiser Steel Corp. v. *Mullins*, 455 U.S. 72 (1982)..... 12

Kardon v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946) 18n

King v. *Drexel Burnham Lambert Inc.*, 791 F.2d 929 (5th Cir. 1986), *petition for cert. filed*, 55 U.S.L.W. 3153 (U.S. Aug. 25, 1986) 3n

McMahon v. *Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986).....2, 3, 6, 13, 19

Mayaja, Inc. v. *Bodkin*, No. 85-2762 slip op. (5th Cir. Oct. 24, 1986).....12n, 13n, 14

Mitsubishi Motors Corp. v. *Soler Chrysler-Plymouth*, ____ U.S. ____, 105 S. Ct. 3346 (1985) .....*passim*

Moran v. *Paine, Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968)..... 8

Morton v. *Mancari*, 417 U.S. 535 (1974) 12

Moses H. Cone Memorial Hospital v. *Mercury Constr. Corp.*, 460 U.S. 1 (1983) 4, 5, 5n, 14, 16

PAGE

Phillips v. *Merrill Lynch, Pierce, Fenner & Smith Inc.*, 795 F.2d 1393 (8th Cir. 1986), *petition for cert. filed*, 55 U.S.L.W. 3296 (U.S. Oct. 7, 1986) (No. 86-578).....3n 9, 10, 15n

Scherk v. *Alberto-Culver Co.*, 417 U.S. 506 (1974).....5, 14, 16

Sedima, S.P.R.L. v. *Imrex Co.*, ____ U.S. ____, 105 S. Ct. 3275 (1985).....13n, 14

Southland Corp. v. *Keating*, 465 U.S. 1 (1984).....4, 5, 5n, 14, 16

Tashea v. *Bache, Halsey, Stuart, Shields, Inc.*, Nos. 85-5768, 85-5769 slip op. (11th Cir. Oct. 21, 1986).....12n, 14

Touche Ross & Co. v. *Redington*, 442 U.S. 560 (1979).....17n, 18n

Wilko v. *Swan*, 346 U.S. 427 (1953).....*passim*

Wolfe v. *E.F. Hutton & Co., Inc.*, 800 F.2d 1032 (11th Cir. 1986).....15n, 18, 19

Statutes:

Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1962-1964 .....*passim*

Securities Act of 1933,
Section 12(2), 15 U.S.C. § 77*l*(2).....*passim*
Section 14, 15 U.S.C. § 77n 16

Securities Exchange Act of 1934,
Section 10(b), 15 U.S.C. § 78j(b) .....*passim*
Section 19, 15 U.S.C. § 78s 7
Section 28, 15 U.S.C. § 78bb 18
Section 29(a), 15 U.S.C. § 78cc(a)..... 16

United States Arbitration Act,
Section 2, 9 U.S.C. § 2.....*passim*

PAGE

Legislative Reports:

H. R. Rep. No. 229, 94th Cong., 1st Sess., reprinted in 1975 U.S. Code Cong. Ad. News 341 18

Rules:

American Stock Exchange, Inc. Arbitration Rules, 2 Am. Stock Ex. Guide (CCH) ¶ 9540-9551J.....6n, 7n, 8n, 9n, 10n

Constitution of the New York Stock Exchange, Inc., Art. VIII, 2 N.Y.S.E. Guide (CCH) ¶ 1351-1357..... 7n

New York Stock Exchange, Inc. Arbitration Rules, 2 N.Y.S.E. Guide (CCH) ¶ 2600-2634.....6n, 7n, 8n, 9n, 10n

Uniform Code of Arbitration, *reprinted in* Fifth Report of the Securities Industry Conference on Arbitration (April 1986) (Exhibit C).....6n, 8n, 9n, 10n

Uniform Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., N.A.S.D. Manual (CCH) ¶¶ 3701-3743 .....6n, 7, 7n, 8n, 10n

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PAGE

Annual Report of the Director of Administrative Office of the United States Courts, Table 19 (1985) 11n

Fifth Report of the Securities Industry Conference on Arbitration Statistical Report (April 1986).....9, 10n, 11n

Securities Exchange Act Release No. 16390, S.E.C. (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979)..... 7

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

No. 86-44

SHEARSON/AMERICAN EXPRESS, INC., and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN, THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN, THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN, and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

BRIEF OF *AMICI CURIAE* IN SUPPORT OF THE PETITIONERS

PRELIMINARY STATEMENT

The Securities Industry Association, Inc. ("SIA"), A.G. Edwards & Sons, Inc. ("A.G. Edwards"), Advest, Inc. ("Advest"), Alex. Brown & Sons Incorporated ("Alex. Brown"), Bateman Eichler, Hill Richards Incorporated ("Bateman Eichler"), Birr Wilson Securities, Inc. ("Birr Wilson"), Boettcher & Company, Inc. ("Boettcher"), The Chicago Corporation ("The Chicago Corporation"), D.A. Davidson & Co. ("Davidson"), Dean Witter Reynolds, Inc. ("Dean Witter"), Dominick & Dominick, Incorporated ("Dominick"), Goldman, Sachs & Co. ("Goldman"), Howard, Weil, Labouisse, Friedrichs Inc. ("Howard Weil"), J.C. Bradford & Co. ("J.C. Bradford"), J.J.B. Hilliard, W.L. Lyons, Inc. ("Hilliard Lyons"), Johnston, Lemon & Co., Incorporated ("Johnston Lemon"), Mer-

rill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), Moseley Securities Corporation ("Moseley"), Nomura Securities International, Inc. ("Nomura"), Piper, Jaffray & Hopwood Incorporated ("Piper Jaffray"), Prescott, Ball & Turben, Inc. ("Prescott Ball"), R.G. Dickinson & Co. ("R.G. Dickinson"), Rauscher Pierce Refsnes, Inc. ("Rauscher Pierce"), Raymond James & Associates, Inc. ("Raymond James"), and Wheat First Securities, Inc. ("Wheat First"), submit this brief as *amici curiae* in support of the Petitioners, and urge this Court to reverse the opinion and judgment of the Second Circuit below in *McMahon* v. *Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986). Pursuant to Rule 36.1 of the Rules of this Court, the written consent of Petitioners Shearson/American Express, Inc., and Mary Ann McNulty and Respondents Eugene and Julia McMahon, The David J. Hodder & Son, Inc. Employee Pension Plan, The David J. Hodder & Son, Inc. Profit Sharing Plan, The Laurie Funeral Home, Inc. Employee Pension Plan, and The Laurie Funeral Home Profit Sharing Plan has been obtained and has been filed with the Clerk of the Court.

INTEREST OF *AMICI CURIAE*

SIA is the principal trade association of the securities industry, having as members more than five hundred securities firms in the United States and Canada. As such, it has a substantial interest in the extent to which agreements to arbitrate claims between securities firms and their customers may be enforced. Because arbitration is an efficient, fair, speedy, and economical manner of resolving disputes, most of SIA's members have agreed with many of their customers to arbitrate any controversies arising between them. Among these members are *amici curiae* A.G. Edwards, Advest, Bateman Eichler, Birr Wilson, Boettcher, The Chicago Corporation, Davidson, Dean Witter, Dominick, Goldman, Hilliard Lyons, Howard Weil, J.C. Bradford, Johnston Lemon, Merrill Lynch, Moseley, Nomura, Piper Jaffray, Prescott Ball, R.G. Dickinson, Rauscher Pierce, Raymond James, and Wheat First.

Certain *amici* are parties to cases pending in this Court and the lower federal courts that involve one or both of the issues presented herein.[1] The procedural outcome of those actions will be affected by the Court's decision herein. *Amici curiae* therefore have a substantial interest in this Court's decision upon whether agreements to arbitrate claims arising under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1962-64 ("RICO"), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (the "Exchange Act"), are enforceable as valid contracts under Section 2 of the United States Arbitration Act, 9 U.S.C. § 2 (the "Arbitration Act"). *Amici* seek to clarify and make uniform the law on these issues so that the enforceability of arbitration provisions in agreements with their customers can be predicted and relied upon. SIA has also filed briefs *amicus curiae* on these issues to this Court in support of the petition for *certiorari* in this action and in *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213 (1985), to the Second Circuit below, and to the Third, Sixth, Eighth, Ninth, and Eleventh Circuits.

SUMMARY OF ARGUMENT

The opinion of the United States Court of Appeals for the Second Circuit below, *McMahon* v. *Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986), which held that predispute arbitration agreements are unenforceable with respect to both RICO and Section 10(b) claims, reflects the suspicion courts once held of the arbitral process, *see Wilko* v. *Swan*, 346 U.S. 427 (1953), rather than recognizing the con-

1 Petitions for *certiorari* have been filed with the Court by *amici* Merrill Lynch and Dean Witter in *Dean Witter Reynolds, Inc.* v. *Conover*, 55 U.S.L.W. 3159 (U.S. Aug. 29, 1986) (No. 86-321), *Merrill Lynch, Pierce, Fenner & Smith Incorporated* v. *Jacobson*, 55 U.S.L.W. 3259 (U.S. Sept. 25, 1986) (No. 86-487), *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 55 U.S.L.W. 3296 (U.S. Oct. 7, 1986) (No. 86-578), and *Merrill Lynch, Pierce, Fenner & Smith Incorporated* v. *Badart*, 55 U.S.L.W. 3317 (U.S. Oct. 10, 1986) (No. 86-591). Petitions have also been filed in at least two other cases raising these issues, *Kidder, Peabody & Co. Incorporated* v. *Intre Sport Ltd.*, 55 U.S.L.W. 3023 (U.S. Jul. 16, 1986) (No. 86-40), and *Drexel Burnham Lambert Inc.* v. *King*, 55 U.S.L.W. 3153 (U.S. Aug. 25, 1986) (No. 86-282).

gressionally enacted federal policy endorsing arbitration as an efficient means of resolving disputes. *See Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, ____ U.S. ____, 105 S. Ct. 3346 (1985); *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984); *Moses H. Cone Memorial Hospital* v. *Mercury Constr. Corp.*, 460 U.S. 1 (1983). That policy is especially appropriate with regard to the securities industry. The various securities exchanges and the National Association of Securities Dealers, Inc., have established permanent arbitration facilities, adopted rules that ensure procedural fairness, and assembled arbitration panels whose competence cannot be questioned. They have done so under the supervision of the Securities and Exchange Commission. Statistical evidence shows that, in cases that are not settled before a hearing, a customer stands an excellent chance of recovering an award from a securities industry arbitration panel.

In addition to its misconception of the policies involved, the Second Circuit failed to apply the correct legal standard: whether Congress manifested an intention to repeal the Arbitration Act with respect to RICO and Section 10(b) claims in the text or legislative history of those statutes. No such intention can be demonstrated with respect to either statute, and the Arbitration Act therefore applies to RICO and Section 10(b) claims.

Last, *Wilko* v. *Swan* does not require a different result with respect to Section 10(b) claims. There, a mistrust of the arbitration process led the Court to hold that predispute agreements to arbitrate were unenforceable as to the unusual, express "special right" of action under Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (the "Securities Act"). The Court's subsequent rejection of those qualms, as well as the reasoning behind the *Wilko* decision, in *Mitsubishi*, raises grave doubts as to *Wilko*'s applicability with respect to claims not brought under Section 12(2). Moreover, the implied right of action under Section 10(b) contains none of the unique features that made Section 12(2) a "special right" and prompted the decision in *Wilko*.

POINT I

ARBITRATION IS FAVORED AS AN EFFICIENT AND WIDELY ACCEPTED MEANS OF RESOLVING BROKER-CUSTOMER DISPUTES IN THE SECURITIES INDUSTRY

The United States Arbitration Act provides that an agreement to arbitrate in a contract involving interstate commerce is valid to the same extent as any other contract. When Congress passed the Arbitration Act in 1925, it established a clear federal policy favoring the use of arbitration to resolve disputes. That policy marked a decisive shift from the hostility to arbitration then prevalent in the courts. Although it did not meet with immediate favor in the courts, *see, e.g., Wilko* v. *Swan*, 346 U.S. 427, this Court has often found occasion to recognize it in recent decisions. In *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, the Court observed:

> [W]e are well past the time when judicial suspicion of the desirability of arbitration and the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.

105 S. Ct. at 3354. *Accord Moses H. Cone Memorial Hospital* v. *Mercury Constr. Corp.*, 460 U.S. at 24 (the Arbitration Act "is a congressional declaration of a liberal federal policy favoring arbitration . . . [and] questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration"); *Southland Corp.* v. *Keating*, 465 U.S. at 10 (in passing the Arbitration Act, "Congress declared a national policy favoring arbitration . . . [that] mandated the enforcement of arbitration agreements"); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974). *See also Wilko* v. *Swan*, 346 U.S. at 439 (Frankfurter, J., dissenting) ("[t]here is nothing in the record . . . to indicate that the arbitral system . . . would not afford the plaintiff the rights to which he is entitled").[2]

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2 The language in *Mitsubishi*, *Moses H. Cone*, and *Southland* echoes Justice Frankfurter's dissenting language in *Wilko*, 346 U.S. at 439,

The opinion of the Second Circuit below ignored the congressionally mandated policy favoring arbitration. That opinion rested on the assumption that arbitration of RICO and Section 10(b) claims will somehow undermine substantive rights under those statutes. In apparent disregard of what this Court has stressed time and again on the subject, the Second Circuit stated, "[I]n other contexts, we have recognized the *inappropriateness* of the United States Arbitration Act when strong public policy considerations are involved." 788 F.2d at 98 (emphasis added). Leaving aside its dubious validity as a matter of law, this assumption is untenable as a matter of fact, especially with regard to the securities industry.

The established structure of arbitration in the securities industry refutes the Second Circuit's assumption that the enforcement of contracts to arbitrate securities disputes will dilute the protection of investors under the securities laws. Securities exchanges and the National Association of Securities Dealers, Inc. (the "N.A.S.D."), under the supervision of the Securities and Exchange Commission, provide arbitration facilities for disputes between member firms and their public customers.[3] The current procedures have evolved since 1872,

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rather than the majority's concern in *Wilko* that arbitration of Section 12(2) claims would endanger the "special rights" created thereby, 346 U.S. at 435. This Court's recent statements thus suggest that the policy underpinnings of *Wilko* no longer retain the same force as when *Wilko* was decided. At the very least, *Wilko* should not be extended beyond the Securities Act to Exchange Act or RICO claims, especially given the dearth of any legislative evidence showing that Congress intended to repeal the Arbitration Act with respect to those claims. *See* discussion, *infra*, at 15-16.

3 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542 (Rule 602); N.A.S.D. Manual (CCH) ¶ 3701; 2 N.Y.S.E. Guide (CCH) ¶ 2600 (Rule 600); Uniform Code of Arbitration § 1, *reprinted in* Fifth Report of the Securities Industry Conference on Arbitration (April 1986) (Exhibit C). The Uniform Code was annexed to the Brief of *Amici Curiae* in Support of the Petition for a Writ of *Certiorari* herein (the "*Certiorari* Brief") as Appendix A. Copies of the arbitration rules of the American Stock Exchange, Inc., the New York Stock Exchange, Inc., and the N.A.S.D. were filed with the Court as Parts I, II, and III of the Supplemental Lodging of *Amici Curiae* in Support of the Petition for a Writ of *Certiorari* herein.

when the New York Stock Exchange, Inc., first adopted arbitration procedures. The N.A.S.D. has maintained arbitration facilities for more than forty years. The exchanges and the N.A.S.D. also have permanent arbitration staffs. Their rules and constitutions contain detailed codes of arbitration procedures.[4] Moreover, the Securities and Exchange Commission has approved the implementation and operation of this arbitral system, *see* Exchange Act Release No. 16390, S.E.C. (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979), and retains jurisdiction to monitor the fairness of arbitration proceedings. *See* Section 19 of the Exchange Act, 15 U.S.C. § 78s.

The long established competence of securities industry arbitrators to adjudicate disputes should dispel any suspicion of the arbitral process in that industry. The stock exchanges and the N.A.S.D. keep permanent lists of arbitrators. These lists comprise senior securities industry personnel, attorneys, and other professionals from outside the industry, who are well versed in the field. *See, e.g.*, Panel of Arbitrators 1986-1987, 1 Am. Stock Ex. Guide (CCH) 157-59; N.A.S.D. Manual (CCH) ¶ 3702. Most have previously served as arbitrators and are therefore well acquainted with arbitration procedures and customs. Thus, this Court's observation in *Mitsubishi* that "adaptability and access to expertise are hallmarks of arbitration," 105 S.Ct. at 3357, hits the mark with respect to the securities industry. Indeed, far from considering themselves as the only tribunal capable of hearing securities disputes, the federal courts have recognized securities industry arbitrators as qualified to resolve those claims. Courts have long compelled arbitration of Section 10(b) disputes between members of a securities exchange or the N.A.S.D. *See, e.g., Axelrod & Co.* v. *Kordich, Victor & Neufeld*, 320 F. Supp. 193 (S.D.N.Y. 1970), *aff'd*, 451 F.2d 838 (2d Cir. 1971); *Brown* v. *Gilligan, Will & Co.*, 287 F. Supp. 766, 772 (S.D.N.Y. 1968). Claims

4 *See, e.g.*, Constitution of the New York Stock Exchange, Inc., Art. VIII, 2 N.Y.S.E. Guide (CCH) ¶¶ 1351-1357; Rules 600-634 of the New York Stock Exchange, Inc., *id.* ¶¶ 2600-2634; Uniform Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., N.A.S.D. Manual (CCH) ¶¶ 3701-3743; Arbitration Rules of the American Stock Exchange, Inc., 2 Am. Stock Ex. Guide (CCH) ¶¶ 9540-9551J.

under Section 10(b) are routinely arbitrated if the public customer chooses to arbitrate. *See*, *Gardner* v. *Shearson, Hammill & Co.*, 433 F.2d 367 (5th Cir. 1970) (per curiam), *cert. denied*, 401 U.S. 978 (1971); *Moran* v. *Paine, Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968); *cf. AVC Nederland B.V.* v. *Atrium Inv. Partnership*, 740 F.2d 148 (2d Cir. 1984) (affirming the dismissal of a Section 10(b) claim because the parties had agreed to try all disputes in the Netherlands).

The arbitration rules of the N.A.S.D. and the various stock exchanges further ensure that arbitration practice in the securities industry will be efficient and impartial. For example, these rules require that panels of arbitrators include members of the securities industry and of the public.[5] They require a majority of "public" arbitrators (i.e., unaffiliated with member firms) in disputes between public customers and member firms unless the customer requests otherwise.[6] Arbitrators are required to disclose any business affiliation with any parties before them, and may be disqualified for cause for even the appearance of a conflict of interest.[7] Each party in an arbitration has at least one peremptory challenge.[8]

The arbitration itself proceeds much like a trial. The parties have the right to be present at the hearing, to be represented by counsel, to cross-examine witnesses, and to take a transcript of the hearing. They may subpoena witnesses and documents just as in a court proceeding, and may also compel the presence of any employee of a member of the sponsoring institution at a

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5 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9541 (Rule 601); N.A.S.D. Manual (CCH) ¶ 3719; 2 N.Y.S.E. Guide (CCH) ¶ 2607 (Rule 607); Uniform Code of Arbitration § 8.

6 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542 (Rule 602); N.A.S.D. Manual (CCH) ¶ 3719; 2 N.Y.S.E. Guide (CCH) ¶ 2607 (Rule 607); Uniform Code of Arbitration § 8.

7 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542(f) (Rule 602)(f); N.A.S.D. Manual (CCH) ¶ 3723; 2 N.Y.S.E. Guide (CCH) ¶ 2610 (Rule 610); Uniform Code of Arbitration § 11.

8 *See, e.g.*, Uniform Code of Arbitration § 10.

hearing, regardless of whether that employee would be within the subpoena power of the courts of the state where the hearing is held.[9] Moreover, arbitrators serve, and witnesses testify, under oath.[10] The fairness of these rules and procedures is borne out by the results of arbitrations conducted under them. In 1985, 55% of public customer cases that went to arbitration before one of the stock exchanges or the N.A.S.D. and were decided—rather than being settled—awarded damages to the customer.[11]

Any lingering doubt as to the efficiency and fairness of arbitration as a means of resolving Section 10(b) or RICO disputes is quelled by the history of *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 795 F.2d 1393 (8th Cir. 1986), *petition for cert. filed*, 55 U.S.L.W. 3296 (U.S. Oct. 7, 1986) (No. 86-578). There, following this Court's decision in *Dean Witter Reynolds Inc.* v. *Byrd*, the plaintiff's state and common law claims were referred to an N.A.S.D. arbitration panel consisting of a former judge of the Illinois Court of Appeals, a professor of law at DePaul University, two attorneys, and the compliance director of a broker-dealer firm. The panel acepted legal briefs from the parties, heard testimony, entertained objections, and allowed both parties to call expert witnesses. The parties made opening and closing statements. At the conclusion of the hearing, counsel for the claimant thanked the panel for affording his client "an opportunity to be heard, a good opportunity, and equal too." *See Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, No. 86-578, Joint Brief for Respondents at 8-9. In July, 1985, the

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9 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶¶ 9546, 9548-49, 9551A (Rules 606, 608-09, 612); 2 N.Y.S.E. Guide (CCH) ¶¶ 2614-15, 2619-20, 2624 (Rules 614-15, 619-20, 624); Uniform Code of Arbitration §§ 15-16, 20-21, 25.

10 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9551B (Rule 613); 2 N.Y.S.E. Guide (CCH) ¶ 2625 (Rule 625); Uniform Code of Arbitration § 26.

11 Fifth Report of the Securities Industry Conference on Arbitration Statistical Report (April 1986) (Exhibit A). This report was annexed to the *Certiorari* Brief as Appendix B.

arbitrators granted an award of $1,200,000 in favor of the plaintiff. The award was confirmed by the district court on September 19, 1985, and has been paid. *See Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 795 F.2d at 1395. Plainly, the arbitrators in *Phillips* were well able to resolve the factual dispute presented to them.

Moreover, the arbitration process significantly reduces discovery expenses and minimizes delay in reaching a hearing. *See Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, 105 S. Ct. at 3358; C. Katsoris, *The Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279, 286 (1984). For example, state laws generally provide subpoena power to arbitrators and counsel, and parties are encouraged to produce documents "to the fullest extent possible without resort to the issuance of the subpoena process."[12] Arbitrators may also direct the appearance of persons associated with member organizations or the production of records of these organizations without using the subpoena process.[13] That most stock exchanges and the N.A.S.D. offer a streamlined arbitration procedure for smaller claims also enables customers to resolve small disputes without incurring great expense.[14] Arbitration also offers an expeditious result. According to statistics compiled by the Securities Industry Conference on Arbitration, nearly 2800 securities industry arbitrations were filed with stock exchanges and the N.A.S.D. in 1985, and 2190 arbitrations in the securities industry were resolved during that year.[15] The 1985 figures

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12 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9548 (Rule 608); N.A.S.D. Manual (CCH) ¶ 3732; 2 N.Y.S.E. Guide (CCH) ¶ 2619 (Rule 619); Uniform Code of Arbitration § 20; C. Katsoris, *supra*, at 286.

13 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9549 (Rule 609); N.A.S.D. Manual (CCH) ¶ 3733; 2 N.Y.S.E. Guide (CCH) ¶ 2620 (Rule 620); Uniform Code of Arbitration § 21.

14 *See, e.g.*, 2 Am. Stock Ex. Guide ¶ 9551H (Rule 619); N.A.S.D. Manual (CCH) ¶ 3710; 2 N.Y.S.E. Guide ¶ 2601 (Rule 601); Uniform Code of Arbitration § 2.

15 *See* Fifth Report of the Securities Industry Conference on Arbitration Statistical Report (April 1986).

represent more than twice the number of arbitrations filed in 1982, an indication of the acceptance arbitration of securities disputes has gained.[16]

Finally, the excessive caseload in the federal district courts makes it all the more important that arbitrable claims between securities firms and their customers proceed to arbitration. Filings of securities and commodities claims have steadily increased to 3266 in 1985.[17] Filings of RICO civil actions have risen as well, from 42 in November, 1985, to 99 in April, 1986.[18] Since the average caseload per federal District Judge in 1985 was 474,[19] referring Section 10(b) and RICO claims to arbitration would effectively create up to six new federal district judgeships, which would help to relieve the federal courts of their overloaded dockets.

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16 The number of filings rose from 1340 in 1982 to 2796 in 1985. *See id.*

17 Annual Report of the Director of the Administrative Office of the United States Courts, Table 19 (1985). Table 19 was annexed to the *Certiorari* Brief as Appendix C. These figures are calculated on the basis of a year beginning July 1. "1985" statistics therefore refer to the period July 1, 1984, through June 30, 1985.

18 Communication from the Administrative Office of the United States Courts, Statistical Analysis and Reports Division.

19 Administrative Office of the United States Courts, Federal Court Management Statistics 1985 at 167.

POINT II

CONGRESS DID NOT REPEAL THE UNITED STATES ARBITRATION ACT WITH RESPECT TO CLAIMS BROUGHT UNDER THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT

Because there is neither a textual conflict between RICO and the Arbitration Act nor any evidence in RICO's legislative history that Congress intended to repeal the Arbitration Act with respect to RICO claims, the Second Circuit erred in holding that RICO claims are not arbitrable.[20] It is well settled that any finding of an implied repeal of the Arbitration Act must be supported by "congressional intention expressed in some other statute," *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, 105 S. Ct. at 3355, which is the traditional standard for finding that a federal statute has been repealed by implication by a subsequently enacted federal statute. *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. at 88 (" 'repeals by implication [of a prior statute by a subsequently enacted one] are disfavored' ") (quoting *Allen* v. *McCurry*, 449 U.S. 90, 99 (1980)); *Morton* v. *Mancari*, 417 U.S. at 550 ("In the absence of some affirmative showing of an intention [by Congress] to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable").

In *Mitsubishi*, this Court stated:

> We must assume that if Congress intended the substantive protection afforded by a given statute to include protec-

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20 Of the other Courts of Appeals that have reached a decision on the issue, the Fifth Circuit has held that RICO claims are arbitrable, *Mayaja, Inc.*, v. *Bodkin*, No. 85-2762 slip op. (5th Cir. Oct. 24, 1986), and the Third and Eleventh Circuits have held that a RICO claim is not arbitrable if predicated on a violation of a federal statute that gives rise to a non-arbitrable right of action, *Jacobson* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 797 F.2d 1197 (3d Cir. 1986); *Tashea* v. *Bache Halsey, Stuart, Shields, Inc.*, Nos 85-5768, 85-5967, slip op. (11th Cir. Oct. 21, 1986).

> tion against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history.

105 S. Ct. at 3355. Under this test, there can be no question that predispute agreements to arbitrate RICO claims are enforceable under the Arbitration Act. RICO contains no statutory language that restricts a party's ability to agree to an arbitral forum with respect to RICO claims, nor is there any evidence in RICO's legislative history that Congress intended to repeal the Arbitration Act with respect to RICO claims. Absent such evidence, the Arbitration Act must apply to RICO claims, and agreements to arbitrate those claims must be honored as ordinary contracts.

The Second Circuit did not pretend to apply the *Mitsubishi* test. It cited no statutory text or legislative history to support a repeal of the Arbitration Act. Instead, it based its holding on "the *inappropriateness* of the United States Arbitration Act when strong public policy considerations"—never identified further—are involved. 788 F.2d at 98 (emphasis added).[21] It made no attempt to balance these "strong public policy considerations" with the express congressional policies embodied in the Arbitration Act, policies that this Court has often affirmed. *E.g.*, *Mitsubishi Motors Corp.* v. *Soler Chrysler-Ply-*

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21 The Second Circuit's attempt to apply to RICO its antitrust decision in *American Safety Equipment Corp.* v. *J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) (holding that antitrust law claims are not subject to predispute arbitration agreements), ignores the "skepticism" this Court expressed about *American Safety* in *Mitsubishi*. 105 S. Ct. at 3357. The Court's criticism of *American Safety* in *Mitsubishi* precludes the application of the *American Safety* decision to RICO claims. The only *American Safety* consideration that this Court recognized as valid in *Mitsubishi* was "the fundamental importance to American democratic capitalism of the regime of the antitrust laws." 105 S. Ct. at 3358. That consideration has no parallel in RICO, especially in its civil aspect, which, as this Court has noted, "is evolving into something quite different from the original conception of its enactors." *Sedima, S.P.R.L.* v. *Imrex Co.*, ___ U.S. ___, 105 S. Ct. 3275, 3287 (1985); *see also Mayaja, Inc.* v. *Bodkin*, *supra*, slip op. at 8 (LEXIS format) ("Mitsubishi rejected so much of *American Safety*'s reasoning that it is difficult to say what is left of the opinion to rely on").

mouth, 105 S. Ct. at 3354; *Southland Corp.* v. *Keating*, 465 U.S. at 10; *Moses H. Cone Memorial Hospital* v. *Mercury Constr. Corp.*, 460 U.S. at 24-25; *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 510-11. In sum, the Second Circuit's substitution of its own policy judgment for the policy Congress mandated in the Arbitration Act cannot stand as a matter of law, and the opinion below should be reversed.

Equally unfounded are the holdings of the Third and Eleventh Circuits in *Jacobson* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 797 F.2d 1197 (3d Cir. 1986), and *Tashea* v. *Bache, Halsey, Stuart, Shields, Inc.*, Nos. 85-5768, 85-5769 slip op. (11th Cir. Oct. 21, 1986): that a RICO claim is not arbitrable if it is predicated on a nonarbitrable claim. What Congress may have intended with respect to a claim based on facts that may also constitute a "predicate offense" under the RICO statute has no bearing on what Congress intended when it created a separate right of action under RICO. That the Third and Eleventh Circuits had to resort to such a tortuous legislative argument vividly reflects their inability to find any basis for an implied repeal of the Arbitration Act in the text or history of the RICO statute.

The holdings in *Jacobson* and *Tashea* also rest on a fundamental misunderstanding of RICO. They assume that a RICO claim is no more than a claim for damages caused by the commission of one of the "predicate offenses" identified in RICO. Yet a "predicate offense" is but one component of a RICO claim. A RICO plaintiff must also prove that the defendants conducted a criminal enterprise and engaged in a pattern of racketeering activity. *Sedima, S.P.R.L.* v. *Imrex Co.*, 105 S. Ct. at 3285. Even if the securities laws were construed to void agreements to arbitrate claims for Section 10(b) fraud, this conclusion does not bear upon whether the distinct elements of a RICO claim based on a Section 10(b) "predicate offense" may be tried before an arbitration panel. *Mayaja, Inc.* v. *Bodkin*, *supra*, slip op. at 8-9 (LEXIS format); *Jacobson* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, *supra*, 797 F.2d at 1209 (Adams, J., dissenting).

POINT III

THE RULE OF *WILKO* v. *SWAN* SHOULD NOT BE EXTENDED TO THE IMPLIED RIGHT OF ACTION UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934

As with its RICO holding, the Second Circuit extended the rule of *Wilko* v. *Swan* to cover Section 10(b) claims without the requisite showing under *Mitsubishi* that Congress intended to repeal the Arbitration Act with respect to such claims. Since there can be no such showing, the decision below should be reversed.[22]

Neither the reasoning nor the facts of *Wilko* v. *Swan* justify its extension to Exchange Act claims. *Wilko* held that a party asserting a claim under Section 12(2) of the Securities Act could not be compelled to submit his claim to arbitration pursuant to a predispute arbitration agreement. The Court expressed concern that arbitrators would be unfamiliar with the "special right" expressly created by Section 12(2), a right that differed significantly from a traditional action for common law fraud. It found that arbitrators, as a matter of federal law, are not subject to "judicial instruction on the law", 346 U.S. at 436, and need give no explanation of their award, and that their "conception of the legal meaning of such statutory requirements as 'burden of proof', 'reasonable care' or 'mate-

22 Since this Court again declared the issue to be an open question in *Dean Witter Reynolds Inc.* v. *Byrd*, the Second Circuit below and the Third, Fifth, Ninth, and Eleventh Circuits have held that predispute agreements to arbitrate are not enforceable with respect to Section 10(b) claims. *Jacobson* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, *supra*, 797 F.2d 1197; *Bustamente* v. *Rotan Mosle, Inc.*, No. 86-2300 slip op. (5th Cir. Oct. 17, 1986); *Conover* v. *Dean Witter Reynolds Inc.*, 794 F.2d 520 (9th Cir. 1986); *Wolfe* v. *E.F. Hutton & Co., Inc.*, 800 F.2d 1032 (11th Cir. 1986). The Eighth Circuit in *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 795 F.2d 1393, held that the Arbitration Act does apply to agreements to arbitrate Section 10(b) claims and renders them as enforceable as any other contract.

rial fact' . . . cannot be examined . . . ." *Id.* The Court accordingly voided predispute agreements to arbitrate as a waiver of substantive rights in violation of Section 14 of the Securities Act, 15 U.S.C. § 77n (voiding any agreement to waive compliance with that Act).

Wilko's reasoning does not easily reconcile with the Court's holdings in *Mitsubishi*, *Byrd*, *Moses H. Cone*, and *Southland*. The confidence those cases showed in the arbitral system—a confidence that is especially justified with respect to the securities industry—parallels Justice Frankfurter's dissenting language in *Wilko* far more closely than it does the majority's doubts in that case as to the availability of a full and fair hearing of securities claims in arbitration. Even more fundamentally, *Wilko*'s assumption that an agreement to arbitrate waives substantive rights stands on precarious footing today. This Court has clearly stated in *Mitsubishi* that, "By agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." 105 S. Ct. at 3355. Unless that statement is to be ignored, unless *Mitsubishi* is to be construed as holding that a waiver of compliance with the antitrust laws is permissible, the reasoning of *Wilko* appears so at odds with *Mitsubishi* as to cast serious doubts on *Wilko*'s validity beyond its peculiar facts.

Moreover, *Wilko* is inapposite by its own terms to an agreement to arbitrate Section 10(b) claims. Although Section 29(a) of the Exchange Act contains a non-waiver provision similar to Section 14 of the Securities Act, 15 U.S.C. § 78cc(a), this Court has acknowledged that its applicability to an implied cause of action under Section 10(b), as opposed to an express private right of action like Section 12(2), is far from clear. *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 215 n.1 (opinion of the Court); *id.* at 224-25 (White, J., concurring); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 515. As Justice White pointed out in his concurring opinion in *Byrd*, the reasoning of *Wilko*

"cannot be mechanically transplanted to" Section 10(b) claims, and *Wilko*'s applicability to Section 10(b) claims "is a matter of substantial doubt." 470 U.S. at 224. The comparison between Sections 12(2) and 10(b) invited by the concurring opinion in *Byrd* proves to a certainty that *Wilko* cannot apply to Section 10(b) claims.

Section 10(b) contains none of the unique provisions upon which the reasoning of *Wilko* is founded. Section 12(2) "*created* a special right" (emphasis supplied) in that it provided a congressionally designed, express private right of action to an aggrieved purchaser of securities. *See Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 209-10 (1976); *Wilko* v. *Swan*, 346 U.S. at 431. In contrast, Section 10(b) does not provide an express private right of action. It contains none of the "carefully drawn procedural restrictions", *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 210, present in the express remedies set forth in the Securities Act and the Exchange Act, but closely resembles a traditional common law fraud action. *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. at 225 (White, J., concurring). Thus, *Wilko*'s concern that arbitrators might not understand the unusual features of Section 12(2)—even if legitimate—finds no parallel in Section 10(b). *Cf. Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, 105 S. Ct. 3354.

That a Section 10(b) claim is only an implied private right of action gainsays that Congress thereby created a "special right" or intended to exempt it from the Arbitration Act, as required by *Mitsubishi*. The private right of action under Section 10(b) is the creation of the lower federal courts in which this Court has acquiesced. *Herman & MacLean* v. *Huddleston*, 459 U.S. 375 (1983).[23] Unlike the express right of action under Section

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23 Because of the history of recognition by the lower federal courts of a private cause of action under Section 10(b), "the existence of this implied remedy is simply beyond peradventure." *Herman & MacLean* v. *Huddleston*, 459 U.S. at 380. Other than noting the failure of

12(2), it cannot be considered part of the statutory scheme of the Exchange Act.[24] Accordingly, neither Section 10(b) nor the legislative history of the Exchange Act permit the conclusion that Congress, in adopting that legislation, thereby intended to repeal the Arbitration Act. It is one thing for the lower federal courts to infer a private right of action for damages where Congress has created none; it is quite another for those courts by so doing to repeal the strong public policy favoring arbitration given effect by Congress in the Arbitration Act.

That Congress, in amending Section 28 of the Exchange Act, 15 U.S.C. § 78bb, in 1975, took note of the decision in *Wilko*, H. R. Rep. No. 229, 94th Cong., 1st Sess., 111, reprinted in 1975 U.S. Code Cong. & Ad. News 321, 342, relied on by the Ninth and Eleventh Circuits in *Conover* v. *Dean Witter Reynolds Incorporated*, 794 F.2d 520 (9th Cir. 1986), and *Wolfe* v. *E.F. Hutton & Co., Inc.*, 800 F.2d 1032 (11th Cir. 1986), has no bearing on the inquiry. How Congress interpreted the Exchange Act more than forty years after its passage does not qualify as evidence of its original intent in passing that Act. That the Ninth and Eleventh Circuits could turn up no legislative evidence contemporaneous with the passage of Section

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Congress to deny a private right of action under Section 10(b) during its numerous amendments of the Exchange Act, a point which often holds little significance in matters of statutory interpretation, *see Girouard* v. *United States*, 328 U.S. 61 (1946), the Court did not examine the legislative intent of Congress in enacting Section 10(b), the critical test for determining whether a right of action is implicit in a federal statute. *See Cort* v. *Ash*, 422 U.S. 66 (1975); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979).

24 The early decisions that inferred a private right of action from Section 10(b) did so not on the basis of factors enumerated in this Court's decision in *Cort* v. *Ash*, 422 U.S. 66 (1975), but on the basis of a "tort" analysis founded on Section 286 of the Restatement of Torts. American Law Institute, Restatement of Torts § 236 (1934). *See Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), and *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951). This analysis was rejected by the Court in *Cort* as a basis for judicial inference of implied causes of action. *See also Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *Cannon* v. *University of Chicago*, 441 U.S. 677 (1979).

10(b) to support an implied repeal of the Arbitration Act confirms that none exists. Moreover, at the time the congressional report cited in *Conover* and *Wolfe* was issued, this Court had clearly held the arbitrability of Section 10(b) claims to be an open question in *Scherk*. *Conover* and *Wolfe* would thus read the congressional report as misstating the law as it then stood with respect to Section 10(b) claims, and their attempt to bootstrap such a misunderstanding into an original intent to repeal the Arbitration Act will not pass muster under *Mitsubishi*.

The Second Circuit based its holding below upon a generalized policy argument of its own making, that "[t]he securities laws generally, and the implied causes of action which the Courts have recognized, are designed to protect the public." 788 F.2d at 98. Yet, since "we are well past judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals," *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, 105 S. Ct. at 3354, this policy argument in no way conflicts with the arbitration of implied Section 10(b) claims. The Second Circuit therefore erred in refusing to enforce the parties' agreement to arbitrate Section 10(b) claims, and its decision should be reversed.

CONCLUSION

For the reasons set forth above, the opinion of the United States Court of Appeals for the Second Circuit should be reversed.

Dated: November 20, 1986

Respectfully submitted,

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No. 86-44

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IN THE

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Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE AND BRIEF FOR WILLIE D. CHANDLER, GEORGE FOX, ALLAN RUPEL AND S. DAVID ROCKOFF AS AMICI CURIAE SUPPORTING RESPONDENTS

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Willie D. Chandler, George Fox, Allan Rupel and S. David Rockoff hereby respectfully move for leave to file the attached brief *amici curiae* in this case. The consent of the attorneys for the respondent has been obtained. The consent of the attorney for the petitioner was requested but refused. Correspondence concerning the requests for permission to file a brief *amici curiae* in this case have been filed with the Clerk of this Court.

The interest of Willie Chandler in this case arises from the fact that he is a party to a case presently pending in the Court of Appeals for the Eleventh Circuit which involves one of the issues before this Court, namely, whether a pre-dispute agreement to arbitrate claims arising under Section 10(b) of the Securities Exchange Act of 1934 is enforceable. *Willie D. Chandler v. Drexel Burnham Lambert, Inc.*, No. 85-8946, C. A.

11. Similarly, the interest of George Fox and Allan Rupel in this case arises from the fact that they are parties to a case presently pending in the Court of Appeals for the Fourth Circuit which involves the same issue. *George Fox and Allan Rupel v. Dean Witter Reynolds, Inc. and Stuart Kimball,* No. 85-2298, C. A. 4 (consolidated for briefing and argument *sub nom. Jan-Olaf Blomquist and Vanja Blomquist v. Dean Witter Reynolds, Inc.,* No. 85-2513, C. A. 4). The interest of S. David Rockoff arises from the fact that he is a party to a case presently pending in the Court of Appeals for the Eleventh Circuit involving both issues before this Court in this case, namely, enforceability of pre-dispute agreements to arbitrate claims under Section 10(b) of the Exchange Act and the arbitrability of claims arising under the Racketeer Influenced Corrupt Organizations Act. *S. David Rockoff, et al v. Shearson-Lehman/American Express, Inc.,* No. 86-5177 C. A. 11.

It is believed that the brief which *amici curiae* are requesting permission to file may contain a more detailed argument than will be presented by the respondents' brief on the issues of Congressional intent to prevent waiver of pre-dispute agreements to arbitrate claims arising under the Exchange Act, including claims under Section 10(b) of that Act, and on the question of the circumstances under which a private litigant is not to be bound by a prospective waiver of a right to proceed in the judicial forum with claims which implicate public concerns. If these arguments are accepted, they will be dispositive of this case.

Date: January 9, 1987 Respectfully submitted,

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QUESTIONS PRESENTED

1. Whether a pre-dispute agreement which waives the provisions of Section 27 of the Securities Exchange Act of 1934 in the context of a private civil action under Section 10(b) of that Act is unenforceable under Section 29(a) thereof as a stipulation waiving compliance with any provision of the Act; and

2. Whether, a private civil action under RICO is arbitrable, since the action implicates the public interest and involves embryonic law?

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF AUTHORITIES	ii
BRIEF AMICI CURIAE	1
Interest of Amici Curiae	1
Summary of Argument	2
ARGUMENT	4
I. Overview	4
II. As a Matter of the Express Intent of Congress, Section 29(a) of the Securities Exchange Act of 1934 is a General Limitation on the United States Arbitration Act and Renders Pre-Dispute Agreements to Arbitrate All Exchange Act Claims Unenforceable	10
III. Consistent With the United States Arbitration Act, A Defendant in a Private Action Under the Racketeer Influenced and Corrupt Organizations Act Does Not Have the Right to Compel Arbitration of the Action Because There is Significant Risk That Arbitration Will Diminish The Public Purpose of the Private Action	16
CONCLUSION	22

TABLE OF AUTHORITIES

	Page
CASES	
Alexander v. Gardner Denver Co., 415 U.S. 36 (1974)	4, 5, 16
Barrentine v. Arkansas-Best Freight Systems Inc., 450 U.S. 728 (1981)	4, 5, 10, 16
Bernhardt v. Polygraphic Company of America, 350 U.S. 198 (1956)	4, 5
Blumenstock Bros. Advertising Agency v. Curtis Publishing Co., 252 U.S. 436 (1920	9
Brooklyn Savings Bank v. O'Neill, 324 U.S. 697 (1945)	17
Cannon v. University of Chicago, 441 U.S. 677 (1979)	10
Chiarella v. United States, 445 U.S. 222 (1980)	10
County of Cook v. Midcon Corp., 574 F. Supp 912 (N.D. Ill. 1983)	19
Dean Witter Reynolds, Inc. v. Byrd, ____U.S.____, 105 S.Ct. 1238 (1985)	5
Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976)	13
Herman & MacLean v. Huddleston, 459 U.S. 375 (1983)	13
Lorrilard v. Pons, 434 U.S. 575 (1978)	13
McDonald v. City of West Branch, Michigan, 104 S. Ct. 1799 (1984)	4, 5, 16
Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353 (1982)	13
Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 105 S. Ct. (1985)	*passim*
Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983)	5
Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., No. 86-1021, slip op. (1st Cir., Nov. 26, 1986) (available on Lexis, Genfed Library, U.S. App. File)	20
Peil v. Speiser, No 85-1360 slip op. (3rd Cir. Nov. 28, 1986)	9
Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967)	5

	Page
Sanders v. Robinson Humphrey/American Express, Inc., 634 F. Supp. 1048 (N.D. Ga. 1986)	2
Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974)	13, 14
Sedima S.P.R.L. v. Imrex Co. Inc., 105 S. Ct. 3275 (1985)	17, 21
Southland Corp. v. Keating, 465 U.S. 1 (1984)	5
Stephenson v. Calpine Conifers II, Ltd., 652 F.2d 808 (9th Cir. 1981)	10
Walton v. Morgan Stanley & Co. Inc., 623 F.2d 796 (2d Cir. 1980)	10
Wilko v. Swan, 346 U.S. 427 (1953)	*passim*
STATUTES, RULES AND REGULATIONS	
United States Arbitration Act	
9 U.S.C. § 1 *et. seq.*	*passim*
Clayton Act	
Section 4, 15 U.S.C. § 815	19
Civil Rights Act of 1964	
Title VII, 42 U.S.C. § 2000 e et seq.	16
Fair Labor Standards Act	
29 U.S.C. § 201-209	16
Racketeer Influenced and Corrupt Organizations Act	
18 U.S.C. § 1961 et seq.	*passim*
Securities Act of 1933	
Section 14, 15 U.S.C. § 77n	*passim*
Section 22(a), 15 U.S.C. § 77v(a)	*passim*
Securities Exchange Act of 1934	
Section 10(b), 15 U.S.C. § 78j(b)	*passim*
Section 15B(b)(2)(D), 15 U.S.C. § 78o-4(b)(2)(D)	12
Section 21(g), 15 U.S.C. § 78u(g)	13
Section 27, 15 U.S.C. § 78aa	*passim*
Section 28(b), 15 U.S.C. § 78bb(b)	11,12
Section 29(a), 15 U.S.C. § 78cc(a)	*passim*
United States Code	
28 U.S.C. § 1407	13
42 U.S.C. § 1983	16

Page

LEGISLATION AND LEGISLATIVE REPORTS

S. 249, 94th Cong., 1st Sess. 1975, 121 Cong. Rec. 11786 13

H.R. Rep. No. 94-229, 94th Congress, 1st Sess. 91, U.S. Code Cong. & Ad. News, 1975, p. 342 12,13

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LEGISLATIVE HEARINGS

Securities Acts Amendments of 1975:

Hearings on S. 249 before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess. 1 (1975) 11

ARTICLES

Cohen and Dayton, *The New Federal Arbitration Law,* 12 Va. L. Rev. 265 (1926) 7

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INTERESTS OF AMICI CURIAE

Amici curiae are customers of securities brokerage firms. Like the respondents in this case, the *amici* signed pre-dispute agreements to arbitrate all disputes arising out of their dealings with the brokerage firms. And like the respondents in this case,

amici are parties to cases pending in the Federal Courts of Appeal that involve one or both of the issues herein.[1] The procedural outcome of those actions will be affected by the Court's decision herein.

In addition, Willie D. Chandler brought his claims under Section 10(b) of the Securities Exchange Act of 1934 on behalf of himself and a proposed class of persons with similar claims. He reasonably believes that the outcome of this case will determine whether class actions against brokerage firms will be viable as a function of a brokerage firm's routine use of pre-dispute arbitration agreements.[2]

Amici seek to clarify and make uniform the law on the issues in this case so that the rights of investors with claims under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (the "Exchange Act") and/or under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1962-64 ("RICO") are certain.

SUMMARY OF ARGUMENT

In *Wilko v. Swan*, 346 U.S. 427 (1953) ("Wilko"), this Court interpreted language in Section 14 of the Securities Act of

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[1] *Willie D. Chandler v. Drexel Burnam Lambert, Inc.*, No. 85-8946 (11th Cir.); *George Fox and Allan Rupel v. Dean Witter Reynolds, Inc. and Stuart Kimball*, No. 85-2298 (4th Cir.); and *S. David Rockoff, et al v. Shearson-Lehman/American Express, Inc.*, No. 86-5177 (11th Cir.). Decisions are pending in each of these cases and, thus, *amici* have not petitioned for writs of certiorari or responded to petitions for writ of certiorari in those cases.

[2] In *Sanders v. Robinson Humphrey/American Express, Inc.*, 634 F. Supp. 1048 (N.D. Ga. 1986), the District Court denied a motion for certification of a plaintiff class based on claims arising under the Securities Act, the Exchange Act and state law. The Court denied the motion primarily because of the pre-dispute arbitration agreements between the defendants and some members of the proposed class. *Sanders*, 634 F. Supp. at 1064-65. The Court said, "To allow class certification where such arbitration agreements exist would not only be unduly burdensome and inefficient should defendants move to compel arbitration but would also violate the requirement of Rule 23(b)(3) that the class action be 'superior to other available methods for the fair and efficient adjudication of the controversy.' Fed. R. Civ. P. 23(b)(3)." *Id.* at 1065.

1933, 15 U.S.C. § 77n (the "Securities Act"), prohibiting the waiver of compliance with any provision of the Securities Act, to mean that investors could not be compelled to waive, in advance of an actual dispute, their right to select between the judicial and arbitrable forms for resolution of Securities Act claims. In 1975, Congress ratified that interpretation. Furthermore, in amending Sections 15B and 28(b) of the Exchange Act in 1975, Congress expressed its intent that Section 29(a) of the Exchange Act, like its equivalent, Section 14 of the Securities Act, operate as a general limitation on the United States Federal Arbitration Act 9 U.S.C. § 1 *et seq.* (the "Arbitration Act"). Because this recognition serves purposes consistent with the policies of the Securities Act and the Exchange Act, and because Congress did ratify Wilko's analysis in Section 14, there is no basis for now assuming that Congress intends for the courts to withdraw from investors the right to wait to select between the judicial and arbitral forums until such time as an actual dispute arises under the Securities Act or the Exchange Act.

The *Wilko* opinion did not spring from prejudice against arbitration. Instead, it merely decided when an investor had the right to choose between the arbitral and judicial forums for resolution of Securities Act claims. In doing so, *Wilko* simply recognized that differences do exist between the arbitral and judicial forums and that investors may perceive those differences to be significant their relationship with those in the securities industry. The Arbitration Act itself does not signify Congressional recognition that the arbitral and judicial forums are equivalent. In recognizing differences between the arbitral and judicial forums which may be or may be perceived to be significant to investors, *Wilko* did no more than this Court has done in a number of other decisions, none of which can be said to be based on this Court's prejudice against arbitration. The opinion of the United States Court of Appeals for the Second Circuit below, *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986) was wholly correct in not retreating from the implications of *Wilko* and Congress' intent that investors not be bound by pre-dispute agreements to arbitrate claims arising under the Exchange Act.

Given that Congress intended that private actions under RICO be judicially enforced and given that private actions under RICO serve to enhance the overall enforcement of RICO's deterrent purposes, it was appropriate for the Court of Appeals below to continue to recognize the validity of the *"American Safety"* doctrine, *American Safety Equipment Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968), especially in light of this Court's consistent recognition of and concern for the risk the arbitration poses to the effectuation of federal statutory remedies. The legal complexity of RICO arising from the unsettled dimensions of its private remedy confirm that the second Circuit's application of the *American Safety* doctrine was appropriate and was not in conflict with any decisions of this Court.

I. Overview

Whether a person should be bound by a pre-dispute arbitration agreement would not be an issue in this or any other case if there were no differences between arbitration and litigation in the courts. However, there are differences. This court has found that, in contrast to the judicial forum, (1) the arbitral forum may not provide the legal expertise required to resolve certain, complex, legal questions; (2) arbitrators may not have authority to enforce statutory remedies; (3) the fact finding process in the arbitral forum does not provide for as complete a record of proceedings as does the judicial forum; (4) arbitration does not apply usual rules of evidence; (5) rights and procedures common to civil trials, including discovery and compulsory process of non-parties, are not available; and (6) judicial review of arbitral proceedings is more limited than judicial review of judicial proceedings. *McDonald v. City of West Branch*, 104 S. Ct. 1799 ("McDonald"); *Barrentine v. Arkansas-Best Freight System, Inc.*, 450 U.S. 728 (1981) ("Barrentine"); *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974) ("Gardner-Denver"); *Bernhardt v. Polygraphic Company of America*, 350 U.S. 198, 203 (1956) ("Bernhardt"); *Wilko v. Swan*, 346 U.S. 427 (1953) ("Wilko").

Because of the differences between the arbitral and judicial forums, this Court has recognized that the choice between the

arbitral and judicial forums inevitably affects the scope of substantive rights to be vindicated, *Gardner-Denver,* 415 U.S. at 56, citing *U.S. Bulk Carriers v. Arguelles,* 400 U.S. 351, 359-360 (1971) (Harlan, J. concurring); that arbitral processes are not commensurate with judicial processes, *id;* that the change from a court of law to an arbitration panel may make a radical difference in ultimate result, *Bernhardt,* 350 U.S. at 203; and that although arbitration is well suited to resolving contractual disputes, it cannot, in certain circumstances, adequately protect federal statutory and constitutional rights. *McDonald,* 104 S.Ct., at 1803-1804, *Barrentine,* 450 U.S., at 740-746, *Gardner-Denver,* 415 U.S., at 56-60. These conclusions cannot be attributed to any supposed prejudice by this court against arbitration. *See generally, Mitsubishi Motors Corp. v. Soler-Chrysler Plymouth, Inc.,* 105 S.Ct. 3346 (1985) (*"Mitsubishi"*); *Dean Witter Reynolds Inc. v. Byrd,* 470 U.S. 213 (1985) *("Byrd"); Southland Corp. v. Keating,* 465 U.S. 1 (1984); *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.,* 460 U.S. 1 (1983) *("Moses H. Cone Memorial Hospital"); Prima Paint Corp. v. Flood & Conklin Mfg. Co.,* 388 U.S. 395 (1967) *("Prima Paint").*[3] Rather, such conclusions are based simply on recognition of the differences between the arbitral and judicial forums.

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[3] The American Arbitration Association ("AAA"), as *amicus curiae* in this case, argues that this court's decision in *Wilko* reflected "precisely the kind of judicial hostility to arbitration that was expressly rejected by Congress in the passing the Arbitration Act." Brief of American Arbitration Association as *Amicus Curiae* in Support of Petitioners, 12 (hereinafter "AAA Brief"). In holding unenforceable pre-dispute agreements to arbitrate claims under Section 12(2) of the Arbitration Act, the Court in *Wilko* did what this Court has done *McDonald, Barrentine, Gardner-Denver and Bernhardt,* that is, it recognized the difference between arbitration and litigation in the Courts. On the basis of those differences and the relationship of Sections 14 and 22 of the Securities Act, the Court determined simply that Congress intended for an investor to have the right to wait until an actual dispute arises before waiving any right to select between the judicial and arbitral forums. Implicit in the *Wilko* opinion is the understanding that, when an actual dispute arises, an investor with a claim under Section 12(2) can choose to arbitrate such a claim. As then-Judge Stevens noted in a dissenting opinion in *Alberto-Culver Co. v. Scherk,* 484 F.2d 611, 615-18 (7th Cir. 1973), *rev'd.,* 417 U.S. 506 (1974), *Wilko* "merely decided *when* plaintiff may not waive a right. . . ."

Although the selection of the arbitral instead of the judicial forum does not *necessarily* mean that rights will not be fully vindicated, the differences between the two forums always pose such a possibility. By signing a pre-dispute arbitration agreement, a party to the agreement always accepts the risk that the arbitration may not fully vindicate rights or may not vindicate them at all.

That there is a federal policy favoring arbitration which compels a hospitable inquiry into the circumstances under which a person waives a right to the judicial forum, *Moses H. Cone Memorial Hospital,* 460 U.S. at 24-5, does not mean that Congress has recognized an equivalence between that forum and the arbitral one. As interpreted by this Court in *Mitsubishi, Byrd, Moses H. Cone,* and *Prima Paint,* the Arbitration Act expresses Congress' recognition *not* that arbitration is equivalent to judicial resolution of dispute but that, in general, it is acceptable, in advance of a dispute, for the parties to contract for and accept the risk that resolution of their dispute will be different from the resolution that would obtain in a judicial forum.

Presumably, persons will not accept that risk if they perceive that the differences between arbitration and litigation in the courts will deprive them of a right.

The legislative history of the Arbitration Act shows if not that the Act "was to have a limited application to contracts between merchants for the interstate shipment of goods . . .", *Prima Paint,* 388 U.S. at 409 (Black, J. dissenting), then at least that Congress' attention was focused only on arbitration of such contracts and not the arbitration of statutory claims. Sales and Contracts to Sell in Interstate and Foreign Commerce, and Federal Commercial Arbitration before a Subcommittee of the Senate Committee on the Judiciary, 67th Cong. 4th Sess., 3, 5, 7, 9, 10 (1923) ("Hearing on S. 4213 and S. 4214"); Arbitration of Interstate Commercial Disputes, Hearing on H.R. 646 and S. 1005 before the Joint Committee of the Subcommittees on the Judiciary, 68th Cong., 1st Sess. 7, 27 (1924) ("Joint

Hearings"). Indeed, one of principal participants in the drafting of and Congressional hearings on the Arbitration Act [4] wrote one year after its enactment:

> Not all questions arising out of contracts ought to be arbitrated. It is a remedy peculiarly suited to the disposition of the ordinary disputes between merchants as to questions of fact—quantity, quality, time of delivery, compliance with terms of payment, excuses for non performance, and the like. It has a place also in the determination of the simpler questions of law—the questions of law which arise out of these daily relations between merchants as to the passage of title, the existence of warranties, or the questions of law which are complementary to the questions of fact which we have just mentioned. It is not the proper method for deciding points of law of major importance involving constitutional questions or policy in the application of statutes. Speaking generally, it is a proper remedy for the determination of these classes of disputes which arise day by day in the common experience of the disputants and the individuals to whom the dispute is to be referred, where all meet upon a common ground.

Cohen and Dayton, *The New Federal Arbitration Law,* 12 Va. L. Rev. 265, 281 (1926)

The petitioners and *amici* supporting the petitioners make the point that arbitration is improved, that the differences between arbitration and judicial litigation have been minimized, and that disputes under Section 10(b) such are as involved in this case are fairly typical, routine disputes—thus, warranting arbitration. Two of these points may be assumed to be true: (1) that arbitration has been improved and (2) that differences between the arbitral and judicial forums have been minimized. It does not follow from this, however, that there are no differences. Judicial review is still limited to review for manifest disregard for the law, not for error. *Wilko,* 346 U.S., at 436-7. Only the AAA, whose rules would not be applied under the arbitration agreement in this case, suggests that arbitrators may provide a statement of the reasons for their

[4] *See,* Joint Hearings, 13 (Statement of Julius Cohen).

decisions, but even then, this is not a matter of AAA rules, but of practice dependant on the request of the parties. AAA Brief, 14, text and n. 15. Thus, there is still a reasonable basis for perceiving differences between the arbitral and judicial forums which may be outcome determinative.

Petitioners assert that the dispute under Section 10(b) involved in this case is "fairly typical." Brief of Petitioners, 36. That may be true in the experience of the petitioners, the members of the securities industry as a whole, and in the experience of the arbitrators who routinely hear such cases. But nothing in the record of this case and no assertion by petitioners or any of the *amici* supporting petitioners even suggests, much less permits the Court to believe, that the dispute here is a "fairly typical" one for the respondents or investors generally.

For the respondents and persons like the respondents, the circumstances of the dispute here cannot be assumed to arise day by day in their experience and to provide a basis for a common ground among the petitioners, the respondents and the arbitrators. The briefs of petitioners and *amici* in support of petitioners compel recognition that the petitioners and arbitrators may share a common ground. This ground is not shared by the respondents or investors like the respondents.

Precisely because there still are differences between the arbitral and judicial forum which an investor might perceive as significant to the outcome of his case and because there is no necessary common ground on which the respondents, petitioners and arbitrators meet in a case under Section 10(b), the legitimate issue is whether Congress intended to and has preserved for an investor the right to wait until a dispute arises to decide which forum to choose. As discussed in Section II of this Argument, Congress did preserve that right.

The common ground between arbitrators, claimants and defendants is eroded further when the nature of a dispute, either because of its factual complexity or legal complexity or some other reason, takes it out of the day-to-day experience of the arbitrator. This would almost always be true where questions of law are not simply complementary to questions of

fact or where the law still requires judicial development. Arbitrators may, under arbitration agreements like the one at issue here, be required to follow the law and may be presumed competent to apply it. However, there can be no presumption that Congress intends for them to develop the law, especially where Congress has provided for exclusive federal jurisdiction and, thereby, has denied presumably competent state courts a role in the interstitial interpretation of a statute. *See, e.g., Blumenstock Bros. Advertising Agency v. Curtis Publishing Co.*, 252 U.S. 436, 440-41 (1920). This is not to say that other considerations would not permit the courts to reduce their sensitivity to a Congressional mandate of exclusive jurisdiction. Thus, in *Mitsubishi,* "concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes," *id.*, 105 S.Ct. at 3355, together with Congress' ratification, 9 U.S.C. § 201 *et seq.*, of the Convention on the Recognition and Enforcement of Arbitral Awards, 21 U.S.T. 2517, T.I.A.S. No. 6997, permitted the Court to enforce a pre-dispute agreement to arbitrate claims under United States antitrust laws in an international transaction where development of and consistent application of United States law may be of less concern than in the non-international context.

Especially where the law is developing, as it still is even under Section 10(b)[5] and RICO,[6] the availability of judicial competence and judicial review are significant to effectuation of statutory law.

As discussed in the next section of this brief, Congress has preserved for investors the right to select the judicial forum for actions under Section 10(b), regardless of the routine experience of arbitrators to apply the law of Section 10(b) in "routine" situations. Even if Congress had not done so, as is true in the RICO statute, it is legitimate and correct to inquire

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[5] For example, the concept of "fraud on the market" as a valid basis for presuming reliance required to prove an action under Section 10(b), is still a developing issue in the federal courts of appeal. *See*, e.g., *Peil v. Speiser*, No. 85-1360, slip op. (3rd Cir., Nov. 28, 1986)

[6] *See, infra*, at 22.

whether constraints external to the parties' arbitration agreement foreclose arbitration. *Mitsubishi,* 105 S.Ct., at 3355. Where, as with *RICO,* the law is nascent and even the courts are troubled by it, or as with the Fair Labor Standards Act, the need for decades of statutory interpretation suggests a difficult area of the law, *Barrentine,* 450 U.S., at 743, the institutional obligation of the courts to enforce federal statutory policy provides a compelling basis for inquiry into a statute's arbitrability. *Id.* at 744-45.

In this case, Section 29(a) of the Exchange Act makes such an inquiry unnecessary as to the arbitrability of investors' claims under Section 10(b). However, as discussed in Section III of this Argument, the inquiry not only is legitimate but also necessary to secure the full implementation of the federal policies of RICO.

II. As a Matter of the Express Intent of Congress, Section 29(a) of the Securities Exchange Act of 1934 is a General Limitation on the United States Arbitration Act and Renders Pre-Dispute Agreements to Arbitrate All Exchange Act Claims Unenforceable.

In the structure and legislative history of the Exchange Act, Congress has manifested its intent that pre-dispute agreements to arbitrate claims arising under that Act, including claims under Section 10(b), are not to be enforced.

Section 27 of the Exchange Act secures for investors in "any and all actions" to "enforce any liability or duty created" by the Act, the right to bring such actions in court, in particular, in the Federal courts. 15 U.S.C. § 78aa. Section 10(b) of the Exchange Act establishes a duty on the part of participants in securities markets not to use manipulative or deceptive devices in connection with the purchase or sale of registered or unregistered securities in interstate commerce. *See, Chiarella v. United States,* 445 U.S. 222 (1980); *Stephenson v. Calpine Conifers II, Limited,* 652 F.2d 808 (9th Cir. 1981); *Walton v. Morgan Stanley & Co., Inc.,* 623 F.2d 796 (2d Cir. 1980). *See also, Cannon v. University of Chicago,* 441 U.S. 667, 690 n.13. Necessarily, Section 27 secures for the Section 10(b) claimant the right to select the judicial forum for resolution of Section

10(b) claims, and, necessarily, a pre-dispute arbitration agreement waives a Section 10(b) claimant's right to select the judicial forum.

Whether Congress has protected against an investor's pre-dispute waiver of Exchange Act rights depends upon the scope of the language of Section 29(a) prohibiting any person to be bound to waive compliance with any provision of the Exchange Act.

That Section 29(a) is a general limitation on the Arbitration Act and secures investors against prospective waiver of their Section 27 rights is confirmed in the text, structure and legislative history of the Exchange Act.

In 1975, as part of the "most substantial and significant revision of this country's federal securities laws since . . . 1934," [7] Congress amended Section 28(b) of the Exchange Act to address arbitration under procedures established by self-regulatory organizations to settle disputes between members or Act to address arbitration under procedures established by self-regulatory organizations ("SRO") to settle disputes between members or participants in the SROs. Sections 28(b)(1) and (2) insure that no other provision of the Exchange Act will operate to bar disputes between members or participants of SROs where the SRO has established such a procedure. Neither Section 28(b)(1) nor Section 28(b)(2) requires a member or participant in the SRO to agree to compulsory arbitration in order to be subject to it. Section 28(b)(3) is different. In order for a person subject to Section 28(b)(3) to be bound to arbitrate a dispute in accordance with SRO arbitration rules governing SRO members or participants, that person must agree to be bound by those rules. Once agreeing to arbitrate, the person cannot be relieved of the contract by resort to any other provisions of the Exchange Act. However, unless there is some other provision of the Exchange Act to resort to avoid the agreement's consequences the general scope of the Arbitration Act would be sufficient to compel a person who agreed to arbitration under SRO rules to honor this agreement.

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[7] Securities Acts Amendments of 1975: Hearings on S. 249 before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess. 1 (1975).

Thus, in the absence of such other provision, Section 28(b)(3) would be wholly unnecessary. At the very least, then, its inclusion expresses Congress' understanding and intent that some provision of the Exchange Act operates as a general limitation on the Arbitration Act, necessitating the provisions of Section 28(b)(3).

Also in 1975, Congress established and enumerated the rule making responsibilities of the Municipal Securities Rule Making Board (the "Board"). Pub. L. 94-29, § 13, 89 Stat. 131. As a result Exchange Act Section 15 B(b)(2)(D), 15 U.S.C. §78o-4(b)(2)(D), empowers the Board to provide for arbitration of "claims, disputes and controversies relating to transactions in municipal securities." *Id.* However, the Board's arbitration rules may not compel a municipal securities customer to submit to such arbitration "except at his instance and in accordance with" Section 29 of the Exchange Act. *Id.* By itself, the language "at his instance" might permit a pre-dispute agreement to arbitrate. But Section 15B(b)(2)(D) requires that the customer's "instance" also be in accordance with Section 29 of the Exchange Act. If Section 29 meant only that a customer cannot waive a dealer's compliance with Exchange Act provisions, then requiring a customer's arbitration agreement to be "in accordance with" Section 29 is essentially meaningless because a dealer's compliance with Exchange Act obligations is not at issue in an arbitration agreement. "In accordance with Section 29" is meaningful, then, only if Section 29 means that a customer is protected from agreements which waive the customer's rights, including rights under Section 27 of the Exchange Act.

That Congress understands and intends that Section 29(a) operates to preclude waiver of a customer's rights under the Exchange Act, and not simply waiver of a defendant's obligations under the Act, is confirmed by the legislative history of the Securities Act Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 (the "1975 Amendments"). In connection with amendments to Exchange Act Section 28(b), the Conference Report stressed: "It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan,* 346 U.S. 427 (1953), concerning the effect of arbi-

tration proceedings provisions and agreements entered into by persons dealing with members and participants of self-regulatory organizations." H.R. Rep. No. 94-229, 94th Cong. 1st Sess., 111 (1975), U.S. Code Cong. & Admin. News, 1975, p. 342 (hereinafter, the "Conference Report").

In *Wilko,* the Court held that Section 14 of the Securities Act prohibited pre-dispute agreements to arbitrate because those agreements waived the customer's rights under Section 22. *Wilko,* 346 U.S., at 432-3, 434-5. *Wilko's* holding is predicated on interpretation of Section 14's "waive compliance" language to prohibit waiver of investors' rights, not just waiver of a seller's obligations under the Act. *Wilko v. Swan,* 346 U.S. at 434-35. The Conference Report confirms that with the 1975 Amendments Congress ratified *Wilko's* interpretation of Section 14. If Congress did not intend Section 14 of the Securities Act (or its equivalent, Section 29(a) of the Exchange Act) to bar the waiver of an investor's rights generally, and not just the waiver of the defendant's obligations under the Act, Congress could have rejected *Wilko's* interpretation of the "waive compliance with" language in Section 14. But, "Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change . . ." *Lorillard v. Pons,* 434 U.S. 575, 580 (1978). *See also, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran,* 456 U.S. 353, 381-2 (1982), *Herman & MacLean v. Huddleston,* 459 U.S. at 385-6. Here, one need not merely presume that Congress was aware of *Wilko's* interpretation of Section 14. The legislative history of Section 28(b) makes clear Congress' full awareness of *Wilko* and its acceptance of the law as articulated by *Wilko.* Necessarily, the equivalence of Section 14 of the Securities Act and Section 29 of the Exchange Act extends *Wilko's* interpretation to the Exchange Act as well.

The Securities Exchange Commission (the "SEC" or the "Commission") minimizes the *Wilko* analysis of Section 14 by noting that *Scherk v. Alberto-Culver Co.,* 417 U.S. 506 (1974), questioned *Wilko's* applicability to Exchange Act claims. *See,* Brief for the Securities and Exchange Commission as Amicus Curiae Supporting Petitioners, 19, n. 14 ("SEC Brief"). This

overlooks the fact that *Scherk* did not criticize or question *Wilko's* analysis of the "waive compliance" language of Section 14 of the Securities Act. In addition, the SEC's analysis overlooks two other important aspects of *Scherk:* (1) *Scherk* accepted *arguendo* the premise that *Wilko v. Swan* did apply in the context of Section 10(b) claims, and (2) *Scherk's* analysis of *Wilko's* applicability was characterized by the Court in *Scherk* as a "colorable argument," not an analysis. In fact, in Part C of the SEC Brief, 21, the Commission itself notes that "... the Court's opinion in *Sherk* [does not go] beyond pointing out *potential* grounds of distinction and indicating the impossibility of automatically and 'mechanically transplant[ing]' the *Wilko* decision to 1934 Act (470 U.S. at 224 ...." Indeed, the majority opinion in *Byrd,* 105 S. Ct. at 1240 n.1, explicitly noted that *Scherk* "did *not* ... hold that *Wilko* would not apply in the context of a Section 10(b) or rule 10(b)-5 claim ...." (Emphasis added.)

If anything, when Congress said that it did not intend to change existing law as articulated in *Wilko v. Swan,* it could not have understood *Scherk* to have been inconsistent with the applicability of *Wilko* in the context of a Section 10(b) claim in a non-international transaction. Furthermore, as the Commission demonstrates convincingly, SEC Brief, 21-26, the potential grounds of distinction raised in *Scherk* do not, on analysis provide a basis for holding that pre-dispute agreements to arbitrate claims arising under Section 10(b) are enforceable.

The Commission also argues that Congress would not now object if this Court were to revise its interpretation of Securities Act Section 14. SEC Brief, 19, n. 14. But this is not necessarily so. The difference between arbitration and litigation, recognition of which does not acknowledge a judicial or legislative prejudice against arbitration, may not *necessarily* dictate a different result as a function of forum selection, but still inherently poses a risk that the choice between arbitration and litigation in courts *might* be outcome determinative. To require an investor to sign a pre-dispute agreement to arbitrate all disputes imposes on the investor the burden of knowing what "all disputes" there might be, the elements of each potential action, and the burden of proof each might require. This is a sophisticated and potentially expensive analysis.

It is surely consistent with the protective philosophy of the Federal securities laws, *Wilko,* 346 U.S., at 431, 435, to protect the investor from this burden. When a dispute arises, the advocates of arbitration and of judicial litigation are no less able to present their competing views to the investor, and if those views are meritorious, the investor is no less able—to the contrary, is better able—to choose the forum whose benefits best suit him. The investor does not lose the right to arbitrate, and by waiting until a dispute arises, the investor is assured that he is on an equal footing with an industry that has ready access to legal resources.

Because of its day-to-day experience with customer disputes, the securities industry may forget that what it views as a "fairly typical" dispute (*see,* Brief of Petitioners, 36) is, to the investor, a matter of tremendous individual importance, both in personal financial terms and in terms of the appearance of the integrity of the marketplace. Protecting the substance and appearance of integrity of investors' relationship to the securities industry at the expense of predictability is as legitimate a congressional concern as protection of integrity of the marketplace itself. Thus, there is no reason to suppose that Congress would relinquish the protective role that Section 29(a) now plays.

In 1975, Congress did provide a specific expression of its intent that pre-dispute agreements to arbitrate Section 10(b) claims should not be enforced. In ratifying *Wilko,* Congress made it clear that Section 29(a) operates broadly to preserve an investor from the risks inherent in the premature waiver of the investor's Exchange Act rights. Thus, to the extent that it prevents pre-dispute waiver of an investor's rights under, among other things, Section 27 of the Exchange Act, it operates as a general limitation on the Arbitration Act. Since Section 27 applies to an action under Section 10(b) of the Exchange Act, Section 29 renders unenforceable pre-dispute agreements to arbitrate Section 10(b) claims.[8]

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[8] Nevertheless, Shearson insists that pre-dispute agreements to arbitrate Section 10(b) claims are enforceable because an action under Section 10(b) of the Exchange Act has been judicially implied and because the action is not, in Shearson's view, "special." Part C of the SEC Brief, 21-26, demonstrates fully why these arguments are not valid.

III. Consistent With the United States Arbitration Act, A Defendant in a Private Action Under the Racketeer Influenced and Corrupt Organizations Act Does Not Have the Right to Compel Arbitration of the Action, Because There is Significant Risk That Arbitration Will Diminish The Action's Public Purpose

It is implicit in every public law which provides a statutory remedy to protect a statutory right that Congress intends for the right to be protected to the fullest. Otherwise, it would not follow that a prospective waiver of a party's right to pursue the statutory remedy would be void as matter of public policy. See, *Mitsubishi,* 105 S. Ct., at 3360, n. 19.

It is also legitimate to assume that where Congress provides for the judicial enforceability of a statutory right, Congress understands that the judicial forum can and will secure the right or any remedy necessary to protect that right to the fullest. In addition, it is legitimate to assume that any alternatives to the judicial forum for resolution or protection of statutory rights and remedies must be essentially equivalent to the forum selected by Congress for the protection of those rights. These assumptions are the premises for this Court's refusal in *McDonald,* 104 S. Ct. at 1804, to fashion a rule that would preclude post-arbitration relitigation in the judicial forum of a claim under 42 U.S.C. § 1983. Similarly, these assumptions are the basis for this Court's refusal to fashion a rule of preclusion in *Barrentine,* 450 U.S., at 740-746, with respect to a claim under the Fair Labor Standards Act, 29 U.S.C. §§ 201-219, or a rule of deferral in *Alexander v. Gardner-Denver Co.,* 415 U.S., at 59-60 for a claim under Title VII of the Civil Rights Act of 1964, 42 U.S.C. 2000e-2000e-17.

Further still, to the extent statutory rights protected by a private civil remedy require special protection or to the extent that pursuit of a private remedy might benefit the public, it is legitimate to inquire into the adequacy of the forum in which the litigant will be compelled to secure a remedy. This follows from the fact that,

> [W]here a private right is granted in the public interest to effectuate a legislative policy, waiver of a

> right so charged or colored with the public interest will not be allowed where it would abort the legislative policy which it was designed to protect.

Brooklyn Savings Bank v. O'Neill, 324 U.S. 697, 704 (1945).

In addition, Congressional provision for exclusive federal jurisdiction, especially where a private remedy implicates the public interest, would seem to reinforce the legitimacy of an inquiry about the forum in which one might be compelled to pursue the remedy, since exclusive jurisdiction serves to insure consistent, uniform development of the law. At issue is not an arbitration tribunal's ability to *apply* the law to a set of facts. If an arbitration tribunal improperly applies the law to a set of facts, only those who are parties to the arbitration are affected. But to the extent that federal courts have thereby been deprived of the opportunity to address issues arising under federal statutes, the law is not *developed* for the benefit of all whom the statute was intended to benefit. Where the private action reinforces public policies expressed in the statute, this is detrimental to the statutory regime.

The private cause of action under RICO is to be judicially enforceable. 18 U.S.C. § 1984(c).

Furthermore, as summarized by the Supreme Court in *Sedima S.P.R.L. v. Imrex Co., Inc.,* 105 S.Ct. 3275 (1985), the legislative history shows that the RICO private remedy is specifically intended to enhance RICO's overall effectiveness:

> RICO formed Title IX of the Organized Crime Control Act of 1970, Pub.L. 91-452, 84 Stat. 922. The civil remedies in the bill passed by the Senate, S.30, were limited to injunctive actions by the United States and became §§ 1964(a), (b), and (d). Previous versions of the legislation, however, had provided for a private treble damages action in exactly the terms ultimately adopted in § 1964(c). *See,* S. 1623, 91st Cong., 1st Sess., § 4(a)(1969); S. 2048, S. 2049, 90th Cong., 1st Sess. (1967).
>
> During hearings on S. 30 before the House Judiciary Committee, Representative Steiger pro-

posed the addition of a private treble damages action "similar to the private damage remedy found in the antitrust laws . . . . [T]hose who have been wronged by organized crime should at least be given access to a legal remedy. *In addition, the availability of such a remedy would enhance the effectiveness of title IX's prohibitions.*" Hearings on S. 30, and related proposals, before Subcommittee No. 5 of the House Committee on the Judiciary, 91st Cong., 2d Sess., 520 (1970) (hereinafter House Hearings). The American Bar Association also proposed an amendment "based upon the concept of Section 4 of the Clayton Act." *Id.*, at 543-544, 548, 559; *see*, 116 Cong. Rec. 25190-25191 (1970). *See* also, H.R. 9327, 91st Cong., 1st Sess. (1969) (House counterpart to S. 1623).

Over the dissent of three members, who feared the treble damages provision would be used for malicious harassment of business competitors, the Committee approved the amendment. H.R. Rep. No. 91-1549, pp. 58, 187 (1970), U.S. Code Cong. & Admin. News 4007. In summarizing the bill on the House floor, its sponsor described the treble damages provision as *"another example of the antitrust remedy being adapted for use against organized criminality."* 116 Cong. Rec. 35295 (1970). The full House then rejected a proposal to create a complementary treble damages remedy for those injured by being named as defendants in malicious private suits. *Id.*, at 35342. Representative Steiger also offered an amendment that would have allowed private injunctive actions, fixed a statute of limitations, and clarified venue and process requirements. *Id.*, at 35346, *see, id.* at 35226-35227. The proposal was greeted with some hostility because it had not been reviewed in Committee, and Steiger withdrew it without a vote being taken. *Id.*, at 35346-35347. The House then passed the bill, with the treble damages provision in the form recommended by the Committee. *Id.*, at 35363-35364.

> The Senate did not seek a conference and adopted the bill as amended in the House. *Id.*, at 36296. The treble damages provision had been drawn to its attention while the legislation was still in the House, and had received the endorsement *of Senator McClellan, the sponsor of S. 30, who was of the view that the provision would be "a major new tool in extirpating the beneful influence of organized crime in our economic life." Id.*, at 25190.

105 S.Ct. at 3280-1 (emphasis added).

Finally, RICO does provide for exclusive jurisdiction of private RICO civil actions. Section 1964c of RICO is nearly identical to 15 U.S.C. § 15, Section 4 of the Clayton Act. As one court has observed:

> [I]t is well established that the identity of language between 18 U.S.C. § 1964(c) and 15 U.S.C. § 15 is not a mere happenstance; Congress consciously patterned the RICO section after the antitrust prototype . . . Legislators must have known that courts have construed virtually identical language as giving federal courts exclusive jurisdiction over antitrust claims. [*See*, e.g., *Freeman v. Bee Machinery Corp.*, 319 U.S. 448, 451 n. 6 . . . *Reh. denied*, 320 U.S. 809 . . . (1943).] *It would be anomalous . . . to hold that the jurisdictional grant under the RICO statute did anything other than create exclusive federal jurisdiction over civil claims by persons injured by violations of 18 U.S.C. § 1962.* (Emphasis added.)

County of Cook v. Midcon Corp., 574 F. Supp. 902, 912 (N.D. Ill. 1983).

Thus, the provision for the judicial enforceability of RICO claims, the importance of the private RICO action to RICO's overall effectiveness and the provision for exclusive federal jurisdiction of the private RICO action, compel inquiry into the competence of an arbitration panel to decide any complex legal questions, if RICO presents them, and compels inquiry into the willingness of arbitrators to recognize constraints of RICO's private statutory rights. Even though an individual has signed a

pre-dispute agreement to arbitrate claims arising under a federal statute, and even through the arbitration act presumes the inclusion of such statutory rights within the scope of a contract, nonetheless, it is legitimate still to examine the interrelationship of the arbitral forum and the legal rights at issue to determine whether or not that interrelationship will protect the statutory rights. That this analysis is appropriate is made plain in *Mitsubishi,* 105 S. Ct. at 3355.[9]

If only because it is still developing, RICO does present difficult and complex legal questions. As the Court noted in *Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc.,* No. 86-1021, slip op. (1st Cir. November 26, 1986) (available on Lexis, Genfed Library, U.S. App. file) (emphasis added):

> . . . [P]laintiffs must show that the series of predicate acts amounted to a 'pattern of racketeering activity.' 18 U.S.C. §§ 1962 and 1964(c). *The meaning of this additional element of a civil RICO claim has yet to be clearly established in the law. See Sedima, S.P.R.L. v. Imrex Co., Inc.* . . . We note, however, that the obligation of plaintiffs to establish the existence of a 'pattern of racketeering activity' is not meaningless. . . .

Thus, although bound to follow the law, an arbitration panel coping with RICO must find it incredibly difficult to determine what the law is. Indeed, although RICO was inactive in 1970, it was not clear until 1985 that a private civil action could be brought under RICO against a defendant who had not already been criminally convicted of a predicate act, and it was not until 1985 that it was clear that a plaintiff in a private civil action under RICO would not have to prove a "racketeering injury" distinct from injury resulting from predicate acts themselves. *Sedima,* 105 S.Ct. at 3275.

---

[9] The *amici,* of course, recognize that the RICO "cause of action" remains at all times under the control of the individual litigant, see *Mitsubishi,* 105 S. Ct. at 3359, and that no citizen is under an obligation either to bring a suit or to obtain executive or judicial approval before settling one, *id.* Nevertheless, the implication of a public interest in a private remedy could compel at least a hospitable inquiry into every opportunity to permit the private litigant to pursue the private remedy in court if that will ensure a full realization of the benefits intended by Congress for the public.

In addition, RICO's nascent nature compels a need for uniform development of the law in the courts, which is only possible by exercise of federal judicial power and full judicial review. In contrast to the situation which obtained in *Barrentine,* 450 U.S. at 743, where statutory questions "must be resolved in light of evidence of legislative history in over four decades of legal interpretation of administrative ruling . . .", the situation here is the opposite. There are not four decades of legal interpretation to help.

Also, it it is not illegitimate to suspect that an arbitration panel might harbor "innate hostility to the constraints on business conduct that" RICO imposes. The courts themselves have been reluctant to impose the "stigma" of racketeering "even though a civil RICO proceeding leaves no greater stain than do a number of other civil proceedings." *Sedima,* 105 S. Ct. at 3283. If the courts are wrestling with the question whether the term "racketeer" should be imposed on certain types of business conduct (*see,* Petitioner's Brief, 47, and cases cited therein), there is a legitimate question whether arbitrators should have to wrestle the same questions.

Thus, all conditions are present in a private civil action under RICO to warrant the conclusion that its enforcement "is particularly appropriate in a judicial forum because of strong policy concerns, the need for development of the record, and judicial clarification and resulting consistency in resolving disputes under this relatively new statute." *McMahon v. Shearson/American Express, Inc.,* 788 F.2d 94, 98-9 (2d Cir. 1986).

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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215-642-8500
Attorneys for Amici Curiae

Richard D. Greenfield
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MOTION FILED
JAN 16 1987

No. 86-44

In the Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS, INC. and
MARY ANN McNULTY,
Petitioners,

vs.

EUGENE McMAHON, JULIA McMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN, THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN, THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN, and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF

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E. L. MENDENHALL, INC., 926 Cherry Street, Kansas City, Mo. 64106, (816) 421-3030

TABLE OF CONTENTS

MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF 1
CERTIFICATE OF SERVICE 5
ORDER 7
EXHIBIT "A" 9
EXHIBIT "B" 11

No. 86-44

In the Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS, INC. and
MARY ANN McNULTY,
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vs.

EUGENE McMAHON, JULIA McMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN, THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN, THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN, and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF

TO THE HONORABLE JUDGE OF SAID COURT:

COME NOW Bruce Cordray, Pamela M. Cordray, Gene C. Griffin, Gertrud Griffin, Mary Grace Norman, Oralia P. Pool, Ofelia Rodriguez de Quijas, Jose Luis Rodriguez Moreno, Martha Leticia Rodriguez Moreno, Luis Alejandro Rodriguez Moreno, Beatriz Rodriguez,

Gloria Storey and Adelina Trapero, by and through their attorney of record, and would respectfully show the Court as follows:

I.

Amici are Plaintiffs in securities and RICO fraud cases now pending in federal district court, Southern District of Texas, Brownsville Division. Amici believe that under Texas law, they have claims which would not be arbitrable but for the Federal Arbitration Act. Such cases not only involve similar legal questions, they also involve Shearson/American Express and the same arbitration clause which was utilized in the case now before this Court.

II.

Amici have sought since November of 1986, the consent of the parties, however only Respondents, as evidenced by Exhibit "A", have granted consent.

III.

As shown by Exhibit "B", counsel for Respondents have made an attempt on behalf of the Amici to secure the consent of Petitioners.

IV.

Amici believe that there exist in this case, facts or questions of law which will not be adequately presented by the parties, some of which are peculiar to Texas law.

V.

Amici believe that this case is of great significance to what can generally be described as consumer protection

law because of the RICO issues involved. So long as a non-arbitrable, broad anti-fraud weapon exists for consumers, the many consumer rights which exist by way of both federal and state statute will not be threatened by adhesion contracts with arbitration terms designed to extract unilateral benefit for the businesses that prepare such contracts. Moreover, unless a reasonable view is taken of the intent of the Federal Arbitration Act and the intent of RICO, other public rights will also be significantly and adversely impacted. Amici would, for example, question the desirability of compelling the arbitration of sexual or racial employment promotion discrimination claims, a result which could be effected through the use of adhesion employment contracts. Nor would it seem reasonable to permit every attorney to use the Federal Arbitration Act to effectively opt out of bar grievance proceedings through utilization of an adhesion arbitration term inserted in client contracts. Given the expansive post-Federal Arbitration Act view of the Commerce Clause, that is a very real possibility.

VI.

Amici further believe that a major premise in this case, that federal district court dockets can be reduced through arbitration of these claims, is not only impermissible, but it is also factually wrong. The simple absence in the Federal Arbitration Act of a definition of arbitration will generate significant litigation since invariably those who create the adhesion contract arbitration terms in non-securities contexts, will create new arbitration forums attempting to extract advantages. An arbitration explosion will also, because of the hundreds of apparently inconsistent state arbitration laws and con-

sumer protection laws, create significant federal court litigation with respect to the threshold question of whether there is sufficient interstate or foreign commerce present to trigger application of the Federal Arbitration Act. That issue is generally not relevant to the securities fraud area and not directly relevant to this case. It is an issue which will be, however, highly relevant to the wave of future attempts in consumer contexts to utilize the Federal Arbitration Act. Further, there will be increased enforcement and review of award involvement by the federal district courts.

VII.

Further, Amici believe that this case does not adequately present significant preliminary legal remedy questions like sequestration and temporary equitable relief, which would be relevant to some arbitration applications not only in the securities field, but also generally in the area of consumer affairs.

VIII.

Finally, Amici believe that the case presented by amici briefs submitted by the parties and by the American Arbitration Association, the Securities Industry, and the Securities and Exchange Commission, do not present an accurate analysis of arbitration itself. Amici, whose lawsuits are pending in federal district court in Brownsville, Texas, would dispute even the most basic tenet of arbitration advanced, namely that it is cost-effective. Most of these Amici live close to federal district court and since the nearest arbitration forum is hundreds of miles distant, arbitration will be anything but cost-effective for them.

WHEREFORE, PREMISES CONSIDERED, Amici request that this Court grant leave to file their Amicus Curiae Brief.

Respectfully submitted,

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1185 F.M. 802, Suite 3
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(512) 544-0561
Attorney for Amici

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Motion for Leave to File Amicus Curiae Brief was served upon the following by First Class Mail, postage pre-paid, this 9th day of January, 1987:

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New York, New York 10048

Eppenstein & Eppenstein
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Attorney for Amici

NO. 86-44

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS, INC. and
MARY ANN McNULTY,
Petitioners,

vs.

EUGENE McMAHON, JULIA McMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN, THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN, THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN, and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

ORDER

CAME ON to be heard the Motion of Bruce Cordray, Pamela M. Cordray, Gene C. Griffin, Gertrud Griffin, Mary Grace Norman, Oralia P. Pool, Ofelia Rodriguez de Quijas, Jose Luis Rodriguez Moreno, Martha Leticia Rodriguez Moreno, Luis Alejandro Rodriguez Moreno, Beatriz Rodriguez, Gloria Storey and Adelina Trapero,

Amici for leave to file an amicus curiae brief in the above styled case and the Court, having considered same, is of the opinion that it should be, and is GRANTED.

.....

Justice Presiding

DATED: .....

EXHIBIT "A"

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1986

SHEARSON/AMERICAN EXPRESS, INC. &
MARY ANN McNULTY,
Petitioners

VS.

EUGENE McMAHON, JULIA McMAHON, Individually and as Trustees of THE DAVID HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,
Respondents

CONSENT TO FILE AMICUS CURIAE BRIEF

COME NOW ORALIA POOL, ADELINA TRAPERO, MARY GRACE NORMAN, MARTHA LETICIA RODRIGUEZ, BEATRIZ RODRIGUEZ, JOSE LUIS RODRIGUEZ, LUIS ALEJANDRO RODRIGUEZ, OFELIA RODRIGUEZ DE QUIZAS, GENE GRIFFIN, GERTRUD GRIFFIN, PAMELA CORDRAY, BRUCE CORDRAY and GLORIA STOREY, by and through their attorney of record Denis A. Downey and submit the following consent for the filing of an Amicus Curiae brief pursuant to Rule 29, Federal Rules of Appellate Procedure:

CONSENT

The undersigned does hereby consent to the filing of an amicus curiae brief by Denis A. Downey on behalf of the above-referenced individuals in the above-styled case.

EPPENSTEIN & EPPENSTEIN, ESQ.
Attorney for Respondents
61 Broadway, Suite 2205
New York, New York 10006
By: /s/ Madelaine Eppenstein

Respectfully submitted

DOWNEY & SULLIVAN
1185 F.M. 802, Suite 3
Brownsville, Texas 78521
(512) 544-0561
By: /s/ Denis A. Downey
Denis A. Downey
Bar Card No. 06085500

EXHIBIT "B"

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December 10, 1986

VIA MESSENGER

Theodore A. Krebsbach
First Vice President
Associate General Counsel
Shearson Lehman Brothers
Two World Trade Center
105th Floor
New York, New York 10048

RE: Shearson v. McMahon, 86-44 (S.Ct.)

Dear Ted:

I have just received copies of the letters you apparently have sent to Mr. Lathrop and Mr. Downey regarding their request to file amicus briefs on behalf of respondents. At my request, your office sent these copies by messenger since as of today we have not received same by mail.

We wish to call your attention to the fact that we voluntarily consented without delay or equivocation to the filing of amici curiae briefs by the following on behalf of petitioners: the American Arbitration Association and the Securities Industry Association, which is comprised of at least two dozen member firms. In light of our cooperation, we honestly cannot understand your failure to likewise grant the request of amici curiae on behalf of respondents, who at this point are only two in number. Both amici who have sought your consent are, we under-

stand, parties to cases pending either in the Supreme Court or the lower federal courts that involve one or all of the issues presented herein. This was the basis upon which we granted our consent to amici submitting briefs on behalf of petitioners.

In a case of this importance, especially where it seems there will be a limited number of amici curiae on both sides, it seems reasonable to assume that the Court wishes to hear from all quarters. As I mentioned in my letter of November 13, 1986, Richard Taranto, Esq. of the Solicitor General's Office, elicited respondents' position in writing. In addition, Mr. Taranto had suggested informally that respondents would be well-advised to enlist amici curiae interested in submitting other views for the Court's consideration. As you well know, the Court is always interested in the views of amici curiae. The parties who have requested your consent, if not given that consent, will be put to the task of motion practice before the Court, which I am sure will not be a welcome burden for the Justices.

Since respondents and their amici curiae deadline is rapidly approaching, we request that you reconsider your position and grant your consent to respondents' amici curiae. Then, it will be up to the Court and not the parties as to what weight to accord same.

We await your response.

Very truly yours,

Madelaine Eppenstein

ME:lma

cc: Stirling Lathrop, Esq.
Denis A. Downey, Esq.
VIA FEDERAL EXPRESS

MOTION FILED
FEB 18 1987

(13)

No. 86-44

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO SUBMIT AMICUS BRIEF; BRIEF AMICUS CURIAE OF STEPHEN NULL

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EILEEN KING
Of Counsel

12 pp

MOTION FOR LEAVE TO SUBMIT UNTIMELY 5-PAGE BRIEF AMICUS CURIAE

Stephen Null respectfully moves for leave to submit his 5-page brief amicus curiae in support of the respondents' position in this Court and in support of the affirmance of the judgment of the United States Court of Appeals holding unenforceable pre-dispute arbitration clauses under section 10(b) of the Securities Exchange Act of 1934 and under RICO.

THE PARTIES' POSITIONS ON THIS MOTION

The respondents have consented to the filing of this amicus brief. The petitioners have declined to consent to its filing.

REASONS FOR GRANTING THE MOTION; INTEREST OF AMICUS

Only 1 week ago the amicus Stephen Null received notice from the present petitioner Shearson of the amicus' interest in this appeal. For the past 5 years, the amicus has been suing Shearson for securities fraud under section 10(b) in the Southern District of New York.* The amicus' action proceeded for 5 years without mention of arbitration until Feb. 6, 1987 when Shearson, for the first time after 5 years, raised an arbitration defense to the amicus' claim, specifically invoking this appeal and this Court's prospective decision. At *no time* prior to Feb. 6, 1987 did Shearson mention, suggest or hint to the amicus that Shearson would seek arbitration of the amicus' claim.

Clearly Shearson prepared its brief in this Court with an eye to all section 10(b) claims against it, including the amicus' claim. Yet the amicus could not have known until Feb. 6, 1987 of his

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* The amicus' action is entitled *Stephen Null v. Lehman Brothers Kuhn Loeb, Inc.*, index no. 80 Civil 7308 (S.D.N.Y.). In 1982 the defendant Lehman Brothers was merged into the petitioner Shearson, so that for the past 5 years since 1982 the amicus has been litigating against the petitioner Shearson.

interest in this appeal. Shearson alone controlled the timing of its arbitration defense against the amicus (Feb. 6, 1987) and thus controlled the disclosure to the amicus of his interest in the present appeal.**

Moreover, the amicus brief is only 5 pages in length and addresses important policy considerations apparently not otherwise addressed in the principal briefs: First, the amicus brief addresses the pervasive and adhesive quality of arbitration clauses in broker-dealer account agreements and thus the danger that their enforcement (because they are industry-wide) would insulate the securities industry from judicial review in the handling of client accounts.

Secondly, the amicus brief addresses the benefits of judicial development and precedent under section 10(b), offering specific examples of judicial protections which would be lost or unannounced in quasi-secret, unreported arbitration decisions.

Thirdly, the amicus brief addresses the integral role which judicial development plays in securing the deterrence function of section 10(b). *Randall v. Loftsgaarden*, 106 S.Ct. 3143, 3154 (1986). The amicus brief points out that: (1) Public deterrence depends upon publicity and reported decisions, whereas arbitration proceedings and decisions are quasi-secret and unreported, and (2) deterrence focuses not only on the parties to a dispute but also on the industry as a whole, whereas the arbitration forum in securities disputes is provided by the very same industry which is the target of the deterrence.

** In the amicus' action, the amicus has several contractual and waiver bases for opposing arbitration, in addition to the statutory basis now before this Court. In the amicus' action, the District Court has not yet ruled on the amicus' contractual, waiver and statutory defenses to arbitration. Thus the amicus has a direct interest in the statutory issues now before this Court, in addition to the amicus' separate contractual and waiver defenses to arbitration.

Significantly, the amicus' contractual defenses may be a vanishing breed. The amicus' arbitration clause was signed in 1979 with Shearson's predecessor Lehman Brothers. Shearson apparently now uses a more comprehensive arbitration clause which, for future signatories, appears to eliminate the contractual defenses available to the amicus. (See amicus brief at p. 1, n.1).

The amicus brief points out that a pervasive deferral to arbitration under industry-wide arbitration clauses not only would insulate the securities industry from judicial review in the handling of client accounts but also would reduce or remove the critical deterrence function of publicly reported decisions rendered in a non-industry forum.

The amicus brief is only 5 pages in length, addresses these critical public-policy considerations, and was delayed only because the petitioner Shearson delayed until Feb. 6, 1987 in informing the amicus Stephen Null that Shearson would invoke against the amicus the parties' arbitration clause following a decision in this appeal. The amicus brief should be accepted.

Dated: New York, New York
February 17, 1987

Respectfully submitted,

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EILEEN KING
Of Counsel

TABLE OF CONTENTS OF BRIEF AMICUS CURIAE

	Page
TABLE OF AUTHORITIES	i
BRIEF AMICUS CURIAE	1
CONCLUSION	5

TABLE OF AUTHORITIES

CASES

Chasins v. Smith Barney & Co., 438 F.2d 1167 (2d Cir. 1970)	3
Clark v. John Lamula Investors, Inc., 583 F.2d 594 (2d Cir. 1978)	3
Randall v. Loftsgaarden, 106 S.Ct. 3143 (1986)	3, 4
Rolf v. Blythe, Eastman Dillon & Co., 570 F.2d 38 (2d Cir. 1978)	3
Shapiro v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974)	3

STATUTES

Section 10(b) of Securities Exchange Act	passim
Sherman Act	4

RULES OF THE SECURITIES AND EXCHANGE COMMISSION

Rule 10b-10	3

BRIEF AMICUS CURIAE OF STEPHEN NULL

The amicus curiae Stephen Null hereby submits his brief in support of the respondents' position in this Court and in support of the affirmance of the judgment of the United States Court of Appeals for the Second Circuit holding unenforceable pre-dispute arbitration clauses under section 10(b) of the Securities Exchange Act of 1934 and under sections 1962 and 1964 of RICO.

There are numerous policy reasons why this Court should affirm the judgment of the Second Circuit.

The enforcement of pre-dispute arbitration clauses would insulate the securities industry from judicial review and guidance in the handling of client accounts. In brokerage agreements, pre-dispute arbitration clauses are pervasive. In 1987 it is virtually impossible to open a brokerage account without signing a broad arbitration clause. The arbitration clauses are adhesion clauses which are industry-wide.[1]

Because arbitration clauses are pervasive, their enforcement would leave no opportunity for judicial development and guidance of broker-dealer obligations in parallel with arbitration. Enforcement of pre-dispute arbitration clauses under section 10(b) would leave the *entire* matter in arbitration.

This contrasts with numerous other legal settings. In numerous legal settings outside the securities industry, judicial development of the law proceeds in tandem with arbitration: The Courts develop and define the law where the parties have not agreed to arbitration, while the arbitrators apply the judicial precedent where the parties agree to arbitrate. Under a given

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[1] The different experiences of both the amicus and the respondents with petitioner Shearson are instructive. In 1979 the amicus signed an arbitration clause (with Shearson's predecessor Lehman Brothers) which is *not* broad and which contains contractual limitations on arbitration. But now Shearson apparently uses a broader, tighter arbitration clause (See pp. A26 and A28 of Second Circuit Appendix). (Amicus has reserved his rights under his 1979 agreement; see attached motion at p. ii, n.**).

body of law, the judicial and arbitral forums proceed in parallel, with the ultimate responsibility placed on the Courts to develop the law for both judicial and arbitral application.

This parallel development would *not* occur in the broker-dealer context if pre-dispute arbitration clauses were enforced. The pervasive and adhesive nature of arbitration clauses in broker-dealer agreements would, if enforced, preclude judicial involvement parallel to the arbitration process and thereby would insulate the securities industry from judicial scrutiny and guidance in the handling of client accounts.[2]

Judicial development and definition have been mainstays of section 10(b). The tables of authorities to the briefs now before this Court are testaments to the judicial solicitude which has guided and defined section 10(b), ensuring that it remains a potent, yet manageable force in the regulation of the nation's securities industry, while simultaneously ensuring that its development remains subject to public and professional scrutiny and criticism. These benefits of publicly guided judicial development would be lost in a pervasive delegation of responsibility to arbitral jurisdiction.

These benefits are as essential in a broker-dealer setting under section 10(b) as in any other setting under section 10(b). Liquidity and confidence in the secondary securities market are essential

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[2] Arbitration clauses also are pervasive in labor-management disputes. However, the labor-management setting (unlike the securities industry) contains built-in checks against arbitral abuse. The underlying labor contract is renegotiated periodically, so that arbitral error (and even the agreement to arbitrate) may be the subject of periodic negotiation.

These built-in checks are *not* present in the securities industry. Aggrieved investors do *not* have the realistic opportunity to renegotiate the standards used in the arbitrations or to avoid the arbitration clauses altogether.

Thus the enforcement of pre-dispute arbitration clauses in the securities industry would insulate the industry from judicial standards and other safeguards which protect investors.

to liquidity and confidence in the primary market. The primary market which finances corporate growth and equity depends upon the secondary market for its own liquidity when primary-market investors seek to realize their gains or limit their losses. The judicial protection and regulation of this secondary market under section 10(b) are integral to the securities laws and to the protections upon which investors depend.

In a broker-dealer setting, the *federal judiciary* has announced and/or developed numerous investor-protections which would be lost or unknown under a pervasive deferral to arbitration. In a broker-dealer context, the *judiciary* has initiated and/or developed, without limitation, the following investor protections: (1) against undisclosed conflicts of interest by broker-dealers who operate as market makers, *Chasins v. Smith Barney & Co.*, 438 F.2d 1167 (2d Cir. 1970),[3] (2) against the use of client-accounts to trade on inside information, *Shapiro v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228 (2d Cir. 1974), (3) against aiding and abetting the purchase of unsuitable securities, *Rolf v. Blythe, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir. 1978), and (4) ensuring the proper measure of damages to compensate for broker-dealer fraud. *Clark v. John Lamula Investors, Inc.*, 583 F.2d 594 (2d Cir. 1978).

The Congressional purpose in enacting section 10(b) inherently requires a judicial forum. Section 10(b) is designed not only to compensate defrauded investors but also to deter fraudulent misconduct in the nation's securities markets. *Randall v. Loftsgaarden*, 106 S.Ct. 3143, 3154 (1986). This deterrence function requires a judicial forum for 2 reasons: First, deterrence focuses not merely on the specific defendants but also on the industry as a whole. Because the securities industry itself is properly the focus of deterrence in private litigation, an arbitral forum provided by the same industry is unlikely to perform this deterrence function.

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[3] As a result of the Second Circuit's decision in *Chasins*, the SEC promulgated Rule 10b-10 requiring disclosure on confirmations of a broker-dealer's position as a market maker.

Secondly, viable deterrence requires *publicity*. Closed arbitral proceedings without public record, without reported findings or conclusions and without published opinions cannot perform the strong public-deterrence function which section 10(b) envisions.

The deterrence function of section 10(b) highlights the irony of the petitioners' present argument. The petitioners (and the securities-industry amicus) argue for enforcement of arbitration clauses because the industry perceives a more sympathetic forum in arbitration. Yet the same reasons for the industry's preference also *reduce* the deterrent effect of an arbitral forum for section 10(b) claims. Thus the true premise of the petitioners' argument itself compels the judicial forum which the petitioners seek to avoid.

Nor can the SEC and the U.S. Attorneys' Offices provide this broad deterrence under section 10(b). The resource and manpower limitations of public authorities limit their efforts to the more flagrant and outrageous cases of fraud. These limitations in the public sector have underscored reliance on private enforcement: "Private rights of action . . . provide a most effective weapon in the enforcement of the securities laws and are a necessary supplement to Commission action." *Randall v. Loftsgaarden*, 106 S.Ct. at 3154 (1986). No less than antitrust plaintiffs who protect the public interest under the Sherman Act, securities plaintiffs protect the public interest under section 10(b) by acting as private attorneys general in prosecuting their individual section 10(b) claims.

During the past 35 years, Congress has not disturbed the virtually consistent holdings of the Courts of Appeals declining to enforce against clients pre-dispute arbitration clauses under section 10(b).

CONCLUSION

The public authorities themselves cannot protect the strong public interests in judicial development of section 10(b) and in deterrence of its violations, thereby placing the responsibility on individual plaintiffs. Nor can individual plaintiffs secure these interests in an arbitral forum with its closed, unexplained and quasi-secret proceedings in an industry-sponsored setting. A broad deferral to arbitration also would insulate the securities industry from judicial review in the handling of client accounts because of the adhesive and industry-wide use of arbitration clauses. A private cause of action in federal court must remain, unencumbered by pre-dispute arbitration clauses.[4]

This Court should affirm the judgment of the United States Court of Appeals for the Second Circuit and should hold unenforceable pre-dispute arbitration clauses in litigation brought under section 10(b) of the Securities Exchange Act of 1934 and under sections 1962 and 1964 of RICO.

Dated: New York, New York
February 17, 1987

Respectfully Submitted,

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EILEEN KING
Of Counsel

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[4] Many of the same arguments which compel adjudication of section 10(b) claims also compel a judicial forum for RICO claims. The interests of brevity in this belated amicus filing compel mention of RICO without repetition of the same arguments applicable to section 10(b).

MOTION FILED
FEB 25 1987

(15)

No. 86-44

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATE COURT OF APPEALS
FOR THE SECOND CIRCUIT

MOTION TO EXTEND THE TIME WITHIN WHICH TO FILE AND MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE SUPPORTING THE INTEREST OF RESPONDENTS AND BRIEF AMICI CURIAE

CARVEL GORDON DILLARD,
as Amici Curiae
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Grants pass, Oregon 97526
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35 pp

TABLE OF CONTENTS

Page

Motion To Extend The Time Within Which To File and Motion For Leave To File Brief... ii

Certificate of Service indicating address of respondents and petitioners viii

Table of Authorities vi

Amici Curiae Brief ..... 1 - 26

Preliminary Statement 1

Interest of Amici Curiae 2

Summary of Argument 3

Argument 8

Conclusion 26

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. AND

MARY ANN MCNULTY,

PETITIONERS

v.

EUGENE MCMAHON, et al

RESPONDENTS

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

MOTION TO EXTEND THE TIME WITHIN WHICH TO FILE AMICI CURIAE BRIEF AND MOTION TO FILE AMICI CURIAE BRIEF.

CARVEL GORDON DILLARD, hearby respectfully moves, pursuant to Rule 42 and Rule 29 and Rule 36 of this Court for an extension of time within which to file Amici Curiae Brief. The consent of respondents has been obtained.

Consent of petitioners has been requested but was not granted.

CARVEL GORDON DILLARD ("Dillard") is a small investor and speculator and is a consumer of brokerage services. Dillard is currently plaintiff in C. G. Dillard v. Merrill Lynch, Pierce, Fenner and Smith Inc., in the United States District Court for the Southern District of Texas, Houston Division, Civil Action No. H 854135. In that case, on September 11th, 1985, Dillard filed his Plaintiff's Motion to Declare Compulsory Arbitration Provisions Of The Brokers Adhesion Contracts To Be Invalid, and Unenforceable and To Enjoin Enforcement Of Same. The District Court has made no ruling on that motion, therefore Dillard has substantial interest in the extent to which agreements between securities firms and their customers to arbitrate claims may be enforced.

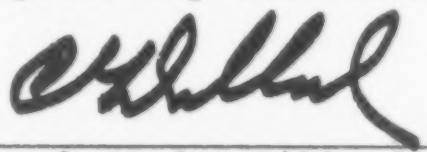
Dillard became aware of the case

currently before this Supreme Court only recently by way of a magazine article and therefore a more prompt response was not possible. Dillard firmly believes that his brief will show the Court that it does not need to make new law or in any way modify existing law in order to acheive a fair, equitable, and elegant solution to the issues currently before the Court. The brief explains why Common Law Of Equity and rights guaranteed under the United States Constitution and Federal Anti Trust Law should govern the Courts action. These issues are of the grestest importance to the people of the United States. Yet the pleadings currently before the Court do not address these issues; although they are the root cause of respondents disclaimer of the validity of the adhesion arbritration clause. Dillard respectfully moves that this Court shall please allow him an extension of time within which to file Amici Curiae Brief

and he respectfully moves that this Court now accept for filing the Amici Curiae Brief. He asks these things in the interst of greater clarity of the issues before the Court and in the interest of justice.

Dated February 19, 1987.

Respectfully Submitted,



Carvel Gordon Dillard
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TABLE OF AUTHORITIES

Page

American Safety Equipment v. J.P. Maguire & Co. (1968) 391 F 2nd 821.....~~10~~ 18

Ames v. Merrill Lynch, Pierce Fenner & Smith Inc. 567 F 2nd 1174 (1977).....~~13~~ 22

17 C.F.R. Section 180.3.....13

Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985).....~~10,12~~ 18,20 21

Federal Arbitration Act 9 USC Section 2..9,14

Fourteenth Amendment To The Constitution Of The United States Of America.....~~1,15~~ 2, 26

Hellenic Lines LTD v. Louis Dreyfus Corp. (1967, CA 2 NY) 372 F 2nd 752.....~~9~~ 15

Moseley v. Electronic Facilities, 374 U.S. 167, 171, 172, (1963).....~~10~~ 17

Paramount Famous Lasky Corporation v. U.S. 282 U.S. 30.....~~5,11,12~~ 8, 9, 14, 19, 22

Prima Paint Corp. v. Flood and Conklin Mfg. Co. 388 U.S. 395, 406 (1967).....~~9~~ 16

'Saving Clause' 388 U.S. 403-404.....~~10~~ 17

Securities Exchange Act Of 1934, 15 U.S.C. Section 78 A et seq.....1,2

Sherman Anti-Trust Act 15 USC Section 1 et seq.....~~1,2,4,5,9,10,15~~ 2, 4, 7, 8, 13, 15, 18, 22, 24, 26

United States v. Paramount Famous Lasky Corporation, 34 F 2nd 984.....~~5,11,12~~ 8, 9, 14, 19, 22

William Goldman Theaters, Inc. v. Loew's Inc. (1945, CA. PA) 150 F 2nd 738..... ~~5~~ 8

Wolff Packing Co. v. Court of Industrial Relations of State of Kansas, 262 U.S. 522. ~~8~~ 13

CERTIFICATE OF SERVICE

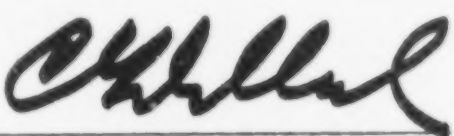
I hearby certify that three true and correct copies of: (1) Motion To Extend the Time Within Which To File (2) Motion For Leave To File Brief Amici Curiae, and (3) Brief Amici Curiae, have been sent by express U.S. certified mail return receipt requested to:

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I do so certify on this 25th day of February 1987.



Carvel Gordon Dillard

No. 86-44

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. AND

MARY ANN MCNULTY,

PETITIONERS

v.

EUGENE MCMAHON, et al

RESPONDENTS

On Writ of Certiorari
To the United States Court of Appeals
For the Second Circuit

Brief Of Amici Curiae In
Support of Respondents

PRELIMINARY STATEMENT

Carvel Gordon Dillard, ("Dillard") submits this Brief as Amici Curiae in support of the respondents and urges this Court to declare that purchasers of securities may not be compelled to relinquish substantive federal statutory rights to judicial review and trial by jury of claims aserted under Section 10 (B) of the Securities Exchange Act

of 1934, 15 U.S.C. Section 78 J (B) in contravention of the Fourteenth Amendment to the United States Constitution and in direct violation of the Sherman Act (15 U.S.C. Sections 1-7).

INTEREST OF AMICI CURIAE

Dillard is a consumer of services provided by the securities industry. In order to effectively trade in securities he was compelled to execute essentially the same adhesion margin agreement contract as was respondents, likewise Dillard subsequently also made claim under Section 10 B-5 of the Securities Exchange Act of 1934; likewise the securities firm which had defrauded Dillard made Motion to Compell Arbitration and Motion That All Disputes Must Be Settled In Arbitration as per the arbitration clause of their adhesion contracts. These matters are still before the District Court for the Southern

District of Texas.

Dillards interest is exactly the same as respondents as regards the 10-B-5 violation and the method the securities firm has attempted to use in order to exempt itself from the consequences of its own illegal acts. The District Court in Houston has over the past seventeen months repeatedly delayed making any ruling --- without explanation for delay. Perhaps it will follow the precident of the Supreme Court in this case. Therefore Dillard has substantial interest in a correct and equitable ruling by this Supreme Court.

SUMMARY OF ARGUMENT

Respondents have stated in their brief that they refuse to concede that the customer arbitration agreements are valid or enforceable. The amici curiae will show that the adhesion arbitration agreements are invalid and unenforceable; due to violations

of law and equity which are grounds for the revocation of any contract.

The securities industry is acting in concert in violation of the Sherman Act; their securities brokerage monopoly acts to restrain the trade of any who refuse to arbitrate. No one can trade in securities on margin without renouncing their freedom of contract and renouncing the protection of law for their property --- rights guaranteed by the Fourteenth Amendment to the United States Constitution.

The contracts in question are adhesion contracts: it is a standard form offered to respondents and to the amici curiae, Dillard, on a "Take it or Leave it" basis without affording realistic opportunity to bargain and under such conditions that respondents could not obtain the desired services except by acquiescing to the form contract. Respondents had no choice as to its terms. Assent was not voluntary, it was coerced by

the advantage of petitioners which was unlawfully exercised. Unlawful advantage of petitioners consisted of threat to prohibit trade of respondents in securities. The threat constituted duress which induced respondents to sign the contracts contrary to respondent's will and to respondent's detriment. Petitioner's threat of restraint of respondent's trade overcame respondent's will and liberty of discretion to such an extent as to influence respondents to act in a way that respondent's judgement and discretion would condemn and prompt them not to do, if free from such influence.

Petitioner's exploitation of unfair advantage in exempting itself from much of the consequences of its own negligence and illegal acts amounts to unfair protection of the interests of petitioner's in so large a manner as to interfere with the public interest. If petitioners had been afforded

the option to choose protection under the law or arbitration then the arbitration provision would be enforceable. But compelling a consumer to renounce his protection under the law upon pain of denial of services is contrary to public policy. If the desired services could be obtained from another brokerage house the petitioners might argue that respondents did not have to trade with it and therefore the duress was not so extreme as to force compliance. But brokerage house services currently are, and at the time of contract were, unavailable to any consumer unless that consumer signs a virtually identical compulsory arbitration provision.

There is a de facto conspiracy of brokerage houses to deprive buyers and sellers of securities of rights to due process and protection of law in securities transactions by restraint of trade and commerce in purchase and sale of securities.

Every major brokerage house has conformed to a uniform pattern of conduct in compelling the execution of a contract containing a compulsory arbitration provision. The amici curiae was unable to find any brokerage house large or small that does not impose upon its customers a contract stipulating compulsory arbitration as a precondition to business. Therefore choice even at another brokerage house was impossible.

Agreement, combination or conspiracy may be inferred from course of dealings warranting conclusion that conspirators had common design, meeting of minds or acted in concert and uniform participation by competitors in a particular system of doing business where each is aware of the other's activities, the effect of which is restraint of interstate commerce is sufficient to establish unlawful conspiracy under the Sherman Act. The amici curiae, Dillard, submits to the Court that petitioners

actions are a violation of the Sherman Act in the manner just described. Please see: William Goldman Theaters, Inc. v. Loew's, Inc. (1945, Ca. 3 Pa.) 150 F2d 738.

ARGUMENT

The United States brought suit in the District court of the United States for the Southern District of New York, attacking the contract in question or a similar one on the ground that it was in violation of the Sherman Anti-Trust Act. In an able opinion, Judge Thacher of that court held the arbitration clause of the contract to be unlawful as being in violation of the Sherman Anti-Trust Act, United States v. Paramount Famous Lasky Corporation, 34 F. (2d) 984, and entered a decree enjoining the Paramount Famous Lasky Corporation, from acting under the arbitration clause in the contract. The opinion and decree of the District Court was affirmed by the Supreme

Court of the United States (Paramount Famous Lasky Corporation v. U.S., 282 U.S. 30, 51 S. Ct. 42, 75 L. Ed.--).

District Judge Thacher adjudged that:

"Trade or commercial groups or traders generally may voluntarily impose on themselves standard forms of agreement which do not unduly restrict competition and thus restrain trade, and may agree that all controversies should be settled by arbitration so long as such agreements are not sought to be imposed on others, regardless of their wishes, by coercive combinations having power to enforce their will.

The conspiracy charged in this case is predicated upon acts of the defendants in adopting and agreeing to use, and in using exclusively, certain uniform contracts for the lease of motion picture films to theater owners throughout the United States, containing provisions for the determination

by arbitration of all claims and controversies arising under said contracts.

...It had been the consistent policy of the distributors to refuse to deal with exhibitors who failed to arbitrate....The coercive effect of this situation has undoubtedly been that, unless exhibitors submitted to arbitration...they have been unable to enter into new contracts.

...One can hardly imagine a more direct restraint upon trade than an agreement betweeen competitors in an open market not to trade except upon terms which they have fixed in advance.

...In judging the inherent character of the restraint one must look not only to the restraint voluntarily imposed upon the competitive activities of those who are in the combination, but also to the involuntary restraint imposed upon the freedom of outsiders to engage in trade under natural and normal conditions. It is therefore not

enough to say that competition between distributors is keen and active, or even that it has been promoted and enhanced by what has been done, if, in fact, it can be seen that the freedom of others to engage in trade, to enter into normal commercial agreements, and to have recourse to the courts for their rights has been unduly restrained by the coercive and collective action of the defendants. That competition between the ditributors has been promoted by the adoption of the standard exhibition contract, and that in many ways general trade conditions have been vastly improved, I have no doubt and so find. But the record is equally clear that all this good has been accomplished through the exercise of irresistible economic force consolidated by combination in the hands of the distributors, who collectively control the available supply of films and by virtue of this control have imposed their will upon the industry. By agreement of

these distributors exhibitors who were not represented in the adoption of the uniform contracts have been constrained to accept their terms regardless of their wishes, and by the complusory system of arbitration, sanctioned and enforced by the collective action of the distributors, have been constrained to perform the contractual obligations thus assumed. In fairness it cannot be said that the restraint imposed upon these exhibitors is voluntary because they accept and agree to be bound by the contracts. They can have none other, because the defendants have agreed that they shall not; and, unless something more than the mere acceptance of all they can get is shown, they must be said to have acted under an involuntary restraint, imposed and continued by the defendants to the end that the contracts shall be signed and their terms obeyed. That such coercive restraint upon the commercial freedom of an exhibitor, who

was neither represented nor consulted with reference to the agreement to adopt the standard form of contract, is undue and unreasonable, both at common law and uder the Sherman Act, I cannot doubt. Gains resulting from such restraints to the industry as a whole do not in the eyes of the statute justify the vicarious sacrifice of the individual, even for the sake of bigger and better business. A state Legislature could not lawfully impose compulsory arbitration upon the motion picture industry. Wolff Packing Co. v. Court of Industrial Relations of State of Kansas, 262 U.S. 522, 43 S. Ct. 630, 67 L. Ed. 1103, 27 ALR 1280. Much less sould it be within the power of a combination of practically all the distributors to do so by coercion exercised through control of the available supply of films.

...The restraint, if not shown to have been voluntary on both sides, is oppressive, and therefore undue and unreasonable.

...Nothing that has been said should be taken in derogation of the right of trade or commercial groups, or of traders generally, to voluntarily impose upon themselves standard forms of agreement which do not unduly restrict competition and thus restrain trade, or to agree that all controversies arising between them shall be settled by arbitration. Such agreements dealing only with the rights of those who execute and intend to be bound by them are normal and usual, and are proper instruments in the lawful conduct of trade. It is only when such agreements are sought to be imposed upon others, regardless of their wishes, by coercive combinations having the power to say 'Take what is offered or get nothing,' that they become illegal."

Dillard's case in the District Court and respondents case in this Supreme Court are indistinguishable from the Paramount Case in all essential elements concerning the

arbitration clause.

Petitioner's alleged right to force arbitration on all its customers whether they like it or not is in conflict with the Fourteenth Amendment to the United States Constitution, and deprives respondents of their property and liberty of contract without due process of law. For this and the other reasons aforementioned amici curiae respectfully submits that petitioners should be enjoined from acting under a compulsory arbitration clause contained in any adhesion contract.

Duress in inducement of arbitration agreement is proper ground for revocation under 9 USCS Sec. 2. See Hellenic Lines LTD v. Louis Dreyfus Corp. (1967, CA 2 NY 372 F2d 753).

The coercion and duress consisted of illegal restraint of trade in violation of the Sherman Act. Amici curiae submits to this Supreme Court that a Sherman Act

violation in the signing of the arbitration agreement voids that agreement. It is fact that the petitioners participate in a coercive combination with its brokerage industry competitors in obvious violation of Federal Anti-Trust Law.

By design no consumer shall anywhere trade securities unless he first renounce protection of law and accept arbitration. The consumer is by duress deprived of the right of voluntary contract making the compulsory arbitration provision no contract at all. It is more simply a unilateral declaration by the brokerage houses in concert; not a mutually agreed contract and as such it is null and void and has no force of law. The amici curiae's allegation of Federal Law violation is directed to the arbitration clause itself -- not the contract generally. Please see: Prima Paint Corp. v. Flood and Conklin Mfg. Co. 388 U.S. 395, 406 (1967): "Accordingly, if the claim is an

illegal act in the inducement of the arbitration clause itself -- an issue which goes to the 'making' of the agreement to arbitrate -- the Federal Court may proceed to adjudicate. This position is consistent both with the decision in Moseley v. Electronic Facilities, 374 U.S. 167, 171, 172 (1963) and with the statutory scheme. As the 'saving clause' in Sec. 2 indicates, the purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so. To immunize an arbitration agreement from judicail challenge ... would be to elevate it over other forms of contract -- a situation inconsistent with the 'saving clause'") see 388 U.S. 403-404).

Federal policy suggesting that arbitration be encouraged did not give license for coercive combinations which operate in restraint of trade; nor does such a policy allow violation of Federal Anti-Trust Law in order to promote arbitration.

It has been established that claims under the Sherman Anti-Trust ACt (15 USCS Sec. 1 et.sq.) are inappropriate for arbitration. Please see American Safety Equipment Corp. v. J. P. Maguire & Co. (1968, CA2 NY) 391 F2d 821, 3 ALR FED 901.

In Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985), this Court pointed out by way of footnote that the decision expressed no view on the validity of arbitration provisions contained in adhesion contracts and that the issue was not addressed because it was not first raised in the lower courts and you thought it improper to address it in the first instance. However, the Supreme Court has previously ruled that an arbitration provision contained in a contract of adhesion is null and void if it is imposed by a participant in powerful coercive combination which acts to restrain trade of those who fail to agree to arbitrate. Until and unless this Supreme Court reverses itself

on that decision it is the law. This case is in every particular exactly the same as the Paramount case (34 F2d 984 and 282 U.S. 30) as regards the agreement to arbitrate and therefore it must be treated under the law in the same manner. In order to validate its adhesion arbitration clause, petitioners must show that this case and the Paramount case are different. But it can not, for they are the same as regards the adhesion arbitration clause. This Court's previous decision clearly outlawed adhesion arbitration clauses which are forced upon a party by monopoly.

Today a film exhibitor can contract for film rental without executing an arbitration agreement. An investor should also be able to deal with a brokerage house under the protection of law. The standard that this Court should impose is that arbitration provisions of brokerage contracts may not be enforced against the party which had no choice because of restraint of trade.

Rejection or acceptance of compulsory arbitration by free choice could be shown upon the contract by the initialing of appropriate box. Similarly, contracts for loans often used to include adhesion provision that insurance, often at high cost, be purchased by the borrower. Lending institutions must now allow the consumer to accept or reject this coverage, which is accomplished by the consumer initialing his choice in an appropriate box upon the contract. The Court should require that if petitioner wants mandatory arbitration it must draft its contracts in such a way that the arbitration provision is not adhesion but rather is shown to be the free choice of the consumer. Once agreement to arbitrate is made, without duress, then and only then is the contract binding with the force of law and the Courts to compel arbitration as per the Byrd decision.

This Court had to assume that no duress

or compulsion by monopoly was involved in the making of the agreement to arbitrate in the Byrd case because that is the way the case came to you. However, unlike the Byrd case, in this case there is allegation by disclaimer that the agreements to arbitrate are not valid or enforceable and the amici curiae has shown violations of Federal Law in the making of the agreement to arbitrate which supports respondent's allegations.

If the securities brokerage industry is allowed to place itself above the law by legislating by contract could not then any monopoly exempt itself from the rule of law by embracing an arbitration panel? Such a policy would be aginst the public interest.

There being no private consent to support a contract of adhesion, its legitimacy rests entirely on its compliance with standards in the public interest. Therefore, petitioner's adhesion arbitration clause must be declared void as a result of

its imposition by monopoly in violation of the Sherman Act as per the Supreme Court's Paramount decision. Petitioners should send a contract addenda to its current customers allowing them to choose either arbitration or the law in the event of future controversy. Legally, the customer must be able to choose either, at the customer's sole option, because the voiding of the contract provision for compulsory arbitration due to compulsion by monopoly is not available to petitioners, although by the law of the Paramount case it currently is to petitioner's customers which include repondents in this case.

The Comodity Futures Trading Commission in 17 C.F.R. Section 180.3 voided arbitration agreements which, inter alia, are not voluntary. The record of Ames v. Merrill Lynch, Pierce, Fenner & Smith Inc. 567 F2d 1174 (1977) shows why: Because the brokerage houses admitted that if a trader did not sign

a compulsory arbitration agreement he was not able to trade effectively and was thus squeezed out of the commodities market. Today we have the exact same situation regarding trading securities in margin accounts: It is impossible to trade effectively in securities without a margin account and an investor can not get one anywhere unless he signs a compulsory arbitration agreement.

The Securities and Exchange Commission which should protect the investor from this abuse shows little concern for the rights of individual investors. This is understandable because the individuals who make up the comission are frequetnly employed by the large brokerage houses prior to and often after their public service. This is not to say that the members of the commission are not good and honorable men - because they are - but because they are often participants in the industry that they are supposed to

regulate, they most often identify philosophically with the providers of securities services rather than consumers. Therefore the commission is ineffective in protecting the rights of consumers and often the commission acts to preserve the overwhelming advantage of the industry to the detriment of consumers.

The Court should recognize the gross violation of existing law exhibited by the securities industry when they legislate by adhesion contract. Prohibit enforcement of compulsory arbitration by adhesion contract and there is no complaint from any investor and no violation of the Fourteenth Amendment and no violation of the Sherman Act and no conflict with the Federal Arbitration Act.

Things will become fair and equitable in securities trading only if a man choose to arbitrate and signs a contract to that effect because he perceives it to be to his own advantage, which free choice and perceived

advantage are the essence of a contract and an unfair adhesion demand upon pain of loss of necessary services is no contract and is contrary to the principles upon which this great nation was founded. And should the Court allow it in this instance what then prevents other coercive combinations from setting up their own arbitration panels and by irresistable economic force and adhesion contract then exempting themselves from the rule of law?

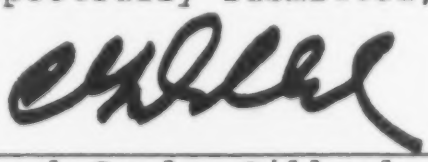
CONCLUSION

Compulsory arbitration by adhesion contract should be enjoined as being in violation of the Fourteenth Amendment to the Consitution of The United States of America.

In the alternative, or additionally, the Court should declare the arbitration clauses contained in the petitioner's adhesion contracts to be void and unenforceable because of violation of Common Laws of Equity and because of violation of the Sherman Anti-Trust Act.

Dated February 23, 1987.

Respectfully Submitted,



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Supreme Court, U.S.
FILED
MAR 2 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-44

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SUPPLEMENTAL MATERIAL FOR RESPONDENTS

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Committee on Energy and Commerce
Room 2125, Rayburn House Office Building
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SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

February 11, 1987

The Honorable John S.R. Shad
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Shad:

Pursuant to Rules X and XI of the Rules of the U.S. House of Representatives, the Subcommittee on Oversight and Investigations is conducting an inquiry into the adequacy of the current self-regulatory system and the Commission's oversight thereof in connection with complaints against broker-dealers for securities-law violations. We are particularly concerned about increasing numbers of complaints in connection with churning and violations of suitability requirements, as well as complaints that arbitration procedures are rife with conflicts of interest (since the arbitrators are peers of the brokerage firm being sued) and are inadequate to enforce the statutory rights of customers against broker-dealers.

This issue is receiving broad national attention.

On January 4, 1987, CBS "60 Minutes" did a segment on an 84-year-old widow named Mrs. Evelyn Anderson whose Paine Webber stockbroker put her into index options in violation of suitability requirements and churned a $321,262.00 account down to $820.00. She filed a lawsuit against Paine Webber and the broker claiming that, in a six-month period in 1984, they

lost approximately $200,000.00 of her estate and generated commissions in excess of $90,000.00. Like many customers, she signed a mandatory agreement waiving the right to sue in federal court and agreeing to settle disputes in arbitration. Mrs. Anderson's case went to arbitration and, after attorney's fees and expenses, she received only $125,000.00 of her losses back.

On December 3, 1986, the *Miami Review* carried an article, "Securities Safeguards: How Secure?," that reported on a $47 million dollar lawsuit by investors whose accounts were churned and placed in unsuitable and highly-leveraged government bond trades by two Dean Witter Reynolds Inc. brokers, John Kenning and John Carpenter. The article states that the scheme grew because two self-regulatory organizations (SROs), one brokerage house, and the SEC did not act on the information they had: all had knowledge of serious allegations against Kenning three years before the SEC finally filed suit. The Commission's Associate Regional Administrator passed the buck to the industry: "...the responsibility...is...up to the brokerage industry to supervise their employees and to make sure people...are adequately trained and adequately supervised."

Five months ago, however, the General Accounting Office (GAO) reported a sharp increase, from 375 in 1982 to 551 in 1983 and 528 in 1984, in securities law violations committed by broker-dealers that were not detected by the SROs. "Securities Regulation: Securities and Exchange Commission Oversight of Self-Regulation," GAO/GGD-86/-83 (September 1986). Some of those missed violations were serious and the GAO report noted: "While some of the violations were missed for understandable reasons such as violations missed through human error, some were caused by more disturbing reasons such as inadequate SRO procedures." GAO report, p. 21. The GAO found "unexperienced examiners and relatively low salary levels at SROs" as well as "weaknesses in examination procedures, misapplication or apparent unfamiliarity with rules, and errors by individual examiners." GAO report, pp. 24-25. The report said that the Commission is referring more responsibility to the SROs notwithstanding that "Commission regional offices considered the SROs to

be less able than the Commission to identify and take effective action on sales practice cases." GAO report, p. 62.

For the years 1985 and 1986, please identify the number of complaints received by the Commission and the SROs in connection with possible churning or suitability violations, how many of these complaints resulted in investigations and their status, how many resulted in SEC enforcement action or SRO disciplinary action, how many were dropped and who made that decision subject to what guidelines, how many were referred to arbitration and, of these latter, how many resulted in findings for the investor and how many for the brokerage house.

The Subcommittee is informed that the Commission has submitted an *amicus curiae* brief on the side of the securities industry rather than investors in the Supreme Court case *Shearson/American Express, Inc. and Mary McNulty v. Eugene McMahon, et al.*, No. 86-44 (1986) concerning whether antifraud cases brought under the Securities Exchange Act of 1934 and the Racketeer Influenced and Corrupt Organizations Act are barred by predispute agreements between brokers and their customers to arbitrate disputes arising out of those contractual relationships. The Commission's position is a reversal of the position the Commission took in a 1975 case in which the SEC said arbitration could not be used to settle fraud claims under Section 10(b) of the 1934 Act and Rule 10b-5 thereunder.

Furthermore, the Commission's brief in the McMahon case argues the *expansiveness* of the SEC's post-1975 regulatory authority and that arbitration is adequate to enforce the firm's duties because:

> ...since 1975 the Securities and Exchange Commission has had extensive authority to oversee and to regulate the arbitration procedures prescribed by stock exchanges and other self-regulatory organizations for use by members (such as petitioner Shearson) in disputes with their customers. See Section 19 of the Exchange Act, 15 U.S.C. 78s. This regulatory authority, as its

> exercise to date demonstrates, can ensure that such arbitration procedures are adequate to protect statutory rights.

Yet, time and time again, the Commission has advised the Committee of serious *limitations* on your authority and in the arbitration process itself. For example, an August 1986 report prepared by the staff of the Commission's Division of Market Regulation stated:

> *The Commission has no authority to review a specific arbitration to assure either compliance with the procedural requirements of the Code or accurate interpretations of underlying federal securities law or other claims by the arbitrators.* The Commission has no authority to overturn an arbitration award, just as it cannot do so in other private dispute resolutions, such as civil litigation. (p. 3)

* * *

> Arbitrations have historically been considered to be private dispute resolution forums. They have not been open to the public, arbitrators generally do not provide written opinions explaining their awards and the awards are generally not known to the public unless disclosed by the parties. (p. 5) (emphasis added)

Please provide the Subcommittee with copies of any documents, memoranda, or notes which discuss, analyze, memorialize, evidence or otherwise relate to the Commission's position on this matter in connection with the 1975 case and its current position in the McMahon case. Advise us of any legislative or regulatory changes you deem appropriate to improve the arbitration process and your oversight thereof.

We would appreciate receiving your response by the close of business on Friday, April 24, 1987. If you have any questions, please contact Michael F. Barrett (225-4441) or Consuela M. Washington (225-2927) of the staff.

Thank you for your cooperation.

Sincerely,

s/
JOHN D. DINGELL
Chairman
Subcommittee on Oversight and Investigations

cc: The Honorable Edward J. Markey
The Honorable Norman F. Lent

Dated: New York, New York
March 2, 1987

Respectfully submitted,

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